THE POLISH ECONOMY

HEARING

BEFORE THE

SUBCOMMITTEE ON EUROPEAN AFFAIRS

OF THE

COMMITTEE ON FOREIGN RELATIONS

UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

THE POLISH ECONOMY AND POLAND'S INTERNATIONAL DEBT: IMPLICATIONS FOR UNITED STATES FOREIGN POLICY

JANUARY 27, 1982

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THE POLISH ECONOMY

WEDNESDAY, JANUARY 27, 1982

UNITED STATES SENATE,
SUBCOMMITTEE ON EUROPEAN AFFAIRS OF THE
COMMITTEE ON FOREIGN RELATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:12 p.m., in room 4221, Dirksen Senate Office Building, Hon. Richard Lugar (chairman of the subcommittee) presiding.

Present: Senators Lugar, Pell, and Biden.

OPENING STATEMENT

Senator LUGAR. This meeting of the European Affairs Subcommittee is now called to order.

We are very pleased at the interest in this hearing, and I thank Senator Biden, my colleague, for his attendance here today. I hope we will be joined by other members of our committee in due course.

I would like to make an opening statement and will then call upon Senator Biden for opening remarks. Then we will proceed to our first panel of witnesses from the administration, who are the Honorable Robert Hormats, Assistant Secretary of State for Business and Economic Affairs, and the Honorable Marc Leland, Assistant Secretary of the Treasury for International Affairs, for their testimony, and then we will have questions for the panel.

Six weeks ago, the Government of Poland instituted martial law, arrested thousands of members of Solidarity, and ended the process of liberalization which was occurring there. That situation persists today. The Reagan administration has taken several steps to indicate its displeasure with the martial law regime and with the obvious Soviet complicity in its establishment.

I support the steps taken by the President. I welcome, too, the strong language adopted in recent NATO statements on Poland. I believe that these statements reflect a common sense of outrage about what is occurring in Poland today.

At the same time, however, I must say that I share the view which Chancellor Schmidt of Germany expressed during his recent visit to the United States. He said that we in the West have a very limited number of options that offer any real prospect of influencing events in Poland. The fact is that restrictions on air travel or exchange programs do not offer meaningful leverage with regard to the future of Poland.

If there is any leverage which the West possesses, if there is any action we could take which would cause the Soviet Union to recalculate

the costs of its intransigence to legitimate reform in Poland, it lies in the sphere of Western economic credits to the East bloc nations.

Poland cannot and will not succeed economically without outside money, money over and above its already massive $27 billion debt. Poland will not attract that money without undergoing significant economic and political reforms. Commercial banks will be reluctant to lend new money without clear indications of economic changes within Poland, nor is there any reason for American taxpayers to contribute further to a system which simply has no prospect for success.

I do not believe that responsible public officials could support further credits to Poland in the foreseeable future.

At this moment, discussions about further rescheduling of Poland's debt have been postponed. We are now at a crossroads which may determine the future of East-West relations for a long time to come. Down one course lies a decision by Poland and Soviet authorities to accept the need for difficult political and economic reforms in Poland, and to permit a liberalized and more broadly independent Polish society. Down the other course lies the total collapse of the Polish economy with its related effect on other East bloc nations.

Commercial banks have already indicated through their actions that they see a relationship between loans to Poland and loans to other East European nations and to the Soviet Union. If Poland continues its downward economic spiral, further loans to any of these nations will become increasingly doubtful. Polish economic collapse will have its own decided effect on other East European economies, perhaps calling into question the entire structure of current Western credit to the East.

These alternatives raise monumental issues which affect many parties. I have called today's hearing to begin to explore with all relevant parties the choices which confront us and the consequences of these choices. I believe that the seriousness of the issues requires more than an ad hoc reaction to moment to moment changes dictated ultimately by the interests of the Soviet Union. It requires a coherent policy which can command the support of the American people and which can achieve as much as it promises.

Senator Biden.

Senator BIDEN. Thank you, Mr. Chairman.

RAISE HOPES AND EXPECTATIONS

I do not have a prepared statement, but I would like to make an opening statement. I would like to begin by complimenting you on your well-reasoned opening statement, and your point of view, which essentially is, we have to find out what is possible, what will work. We in politics ofttimes are very tempted to engage in rhetorical flourishes and excesses which raise hopes and expectations, but in fact have little relationship to what we are able or not able to do.

Like you, Mr. Chairman, I am worried about East-West relations and the impact it will have on direct United States-Soviet relations, and the impact it will have on the entire Eastern bloc group of nations, but I am equally as worried about West-West relations. I feel that the Soviets may very well obtain a double victory, if you will, if we do not move with a good deal of sophistication and perception.

I believe that the Soviet Union may very well achieve its goal in Poland, which is to smash Solidarity, to eliminate and snuff out the reforms, not unlike they did in Prague in the late sixties, and at the same time to cause such a breach and split in the Western alliance that they will have rendered us a serious defeat and themselves some additional breathing room.

I am very concerned about the course that the debate is taking in this country with regard to the role our NATO allies play or do not play in the reaction to the situation in Poland. Germany is a case in point. If I am not mistaken, Germany has somewhere in excess of three times the amount of debt that we do, and it has one-third the economy that we have, in rough terms. The fact of the matter is, I have seen little evidence, notwithstanding the fact that the last administration and this administration have indicated that they were about the business of finding a mutually advantageous position for all the allies to take, of any indication on our part to share the burden equally, whatever sanctions we ultimately employ.

CONCEPT OF BURDEN SHARING

When I chaired this subcommittee, and now as the ranking member of the subcommittee, Senator Lugar and I had many discussions and hearings. We heard witnesses about the concept of burden sharing. We Americans were ready and anxious to talk about burden sharing when it came to the Persian Gulf. We lectured our German friends and continue to lecture them on how they have as much at stake in the gulf region as we do.

We talked to our other NATO friends about how they had to help share the burden of carrying liberty and freedom around the world, and yet it is clear that whatever burden would be imposed as a consequence of sanctions which relate to default on the debt or not refunding the debt or not rescheduling the debt will fall much more heavily upon our European allies than they will on us, significantly more heavily on our European allies than on us.

Some of us in the Congress, some few in the administration, and some few of the last administration, have spent a good deal of time castigating our fellow allies about what they are not willing to do, and how they are wedded to commerce more than they are to freedom, and here, we come along and just approve a $300 million International Harvester deal with the Soviet Union, to teach them a lesson. I should say a $300 million deal which, if the estimates are correct, may very well enable them to increase their crop yield by 25 percent over the next decade.

At the same time, we are also telling our European friends that they should not be involved in the gas pipeline deal. We are telling them that we do not see much problem in trading more wheat with the Soviet Union than we ever have in our entire history.

MANY INCONSISTENCIES

The point I am trying to make is, there are a number of inconsistencies, not coming out of State or Defense, but coming out of the U.S. Congress, and parts of the administration, which seems to gain wide-

spread currency in the United States as affecting and offending our European allies significantly, and I think with some good reason.

I worry very much that whatever we do not only impacts upon the plight of the people of Poland, but also does nothing to seriously damage our naked self-interest in the continued strength of the NATO alliance, which is very important to us, as I am sure you all agree.

I hope in our question and answer period we will discuss not only the East-West implications of what we do, but the West-West implications of what we do or do not do.

Thank you, Mr. Chairman, for allowing me the opportunity to make an opening statement.

Senator LUGAR. Thank you, Senator Biden.

We have been joined by Senator Pell, the ranking minority member of the Senate Foreign Relations Committee.

Do you have an opening statement, Senator Pell?

Senator PELL. I have no opening statement, Mr. Chairman. Thank you very much.

Senator LUGAR. Before recognizing Mr. Hormats, let me mention that we have been joined during the opening statements by a distinguished delegation from Great Britain. Conservative and Labor members of Parliament are in our midst.

If you would stand, please, the committee would like to recognize your presence. [General applause.]

We thank you very much.

Mr. Hormats.

STATEMENT OF ROBERT HORMATS, ASSISTANT SECRETARY FOR BUSINESS AND ECONOMIC AFFAIRS, DEPARTMENT OF STATE, ACCOMPANIED BY AMBASSADOR CHARLES MEISSNER, SPECIAL ECONOMIC NEGOTIATOR, DEPARTMENT OF STATE

Mr. HORMATS. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before your subcommittee today to discuss the Polish economic and financial situation. The State and Treasury Departments have prepared a short background paper and fact sheet which gives you the salient details. At the outset, prior to taking questions, I would like to give you an overview of U.S. policy and actions since the imposition of martial law in Poland.

There can be no doubt but that the Soviet Union bears a heavy responsibility for and is directly and deeply involved in the repression in Poland. It is supporting the efforts of the Polish martial law regime to crush Solidarity and to return to a more repressive form of control. There has been no indication that the situation will improve. On the contrary, the grip of martial law appears to grow tighter. Jaruzelski's January 25 speech to the Polish Party made no mention of genuine movement to lift martial law, release prisoners, or return to genuine dialog. It was essentially a weak effort to justify the continuing suppression of the Polish people.

In these circumstances, our continuing objective is to apply sustained pressure on both Poland and the Soviet Union to have martial law lifted, the prisoners released, and the dialog between the government, the church and Solidarity begun in earnest in a free atmos-

phere. In short, our goal is the restoration of the process of reform and renewal in Poland.

We have taken a number of specific steps of which you are all aware, and which are listed in the background paper. We are augmenting our efforts by encouraging our allies to take actions which are parallel with ours or, at a minimum, to not undermine our effort.

We have been working closely with our allies. The NATO Ministerial of January 11 produced a strong declaration deploring the Polish situation. In that statement, the allies agreed to take some specific actions and to consult on other short and long-term measures. Western official creditors met on January 14 and reaffirmed the NATO Ministers' decision to hold in suspense rescheduling negotiations on Poland's 1982 debt.

I agree with you, Mr. Chairman, that it would be quite wrong for any public official to consider support for further credits to Poland in the foreseeable future, as long as the current situation continues, and particularly, of course, if it deteriorates, as we believe it is doing now.

We believe that the allied actions taken so far in the financial area, for example, not providing new commercial credits to Poland, suspension of debt rescheduling negotiations, restricting food credits except for humanitarian purposes, are steps in the right direction. They have made it clear to the Polish regime that it will pay a price for its repression.

At the same time, we and our allies have taken measures vis-a-vis the Soviets and are considering additional actions. On January 23, the NATO allies met in a "reinforced" session of the North Atlantic Council and reaffirmed the aim of exerting steady and graduated pressures; they indicated a range of steps that their governments have taken and others that they are considering for implementation in the immediate future.

At present, we and our allies are considering what more we can do to bring effective economic pressure to bear on the Soviets and to bring home to them the costs of continued support and encouragement of the repression of the Polish people by the regime in Warsaw. While we and our allies may apply different types of pressures, I am confident that we share the same objectives. The North Atlantic Council Declaration of January 11 stressed a strong common commitment to reestablishment of civil liberties and the process of reform in Poland.

What we are witnessing now in Poland is a breakdown in the system that the Soviets have imposed on Eastern Europe. Communism has failed in Poland, and the regime has resorted to military repression. The crackdown in Poland and related events demonstrate the weakness in the Communist system. The Soviet Union is now trying to turn its failure in Poland into a foreign policy victory in the West by attempting to divide the Western Alliance.

Senator Biden has made a very key point, something that we have to be aware of as we develop our policies; and as we developed our policies in the past, we have tried to take this into account.

Our objective is to maintain and indeed strengthen allied unity in support of sustained pressures on both Poland and the Soviets to end the repression of the Polish people. The President, by taking the lead

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in the measures announced in his December 29 statement, has encouraged a strengthened allied reaction, and he stated in last night's state of the Union address that if the events in Poland continue to deteriorate, further measures will follow.

One source of pressure on the Polish regime which you have mentioned, Mr. Chairman, is to insist that they pay their debts to the West. We and our allies are united on this objective. We have also agreed not to begin negotiations for the rescheduling of the debt Poland owes us in 1982. In this, as in other areas, we will consider additional actions in light of the evolving situation in Poland.

Let me conclude, Mr. Chairman, by stressing our strongly held view that it is vital that at this crucial point in history, the West make clear to Warsaw and Moscow that we will continue to provide sustained pressure as long as the violations of internationally recognized human rights continue in Poland.

I thank you, Mr. Chairman.

Senator LUGAR. Thank you very much, Mr. Hormats.

Mr. Leland, we are prepared to accept your testimony.

TESTIMONY OF MARC LELAND, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY, ACCOMPANIED BY R. A. CORNELL, DEPUTY ASSISTANT SECRETARY OF THE TREASURY FOR TRADE AND INVESTMENT

Mr. LELAND. Thank you, Mr. Chairman. I am pleased to be here today to discuss with you and the members of the committee this important issue of the Polish economic and financial situation. I do not have a prepared statement, but would like to make a few comments.

As you know, we have provided the committee a background paper which explains just what Poland's current economic situation is and how it got there. To begin with, the paper gives the background on Poland's economic strategy in the seventies; how and why its debt grew; the mistakes that were made, largely due to the weaknesses of its centrally directed economic system by its planners; and how it ended up where it was in 1981.

As Bob Hormats has said, and what happened on the 13th of December is something that everybody takes very seriously. We feel we must do everything we possibly can to undo those actions. The ending of martial law, the release of the prisoners are things that are very important. Moreover, Poland has a large debt and insofar as it can be an element of pressure, it should be used to help achieve those objectives.

In this connection, I think Senator Biden brings up the valid point that we don't want the pressure to be used or to end up being turned against us, so to some degree we have to consider what the reaction of your allies is going to be to whatever steps we might consider. In East-West relations overall, particularly their economic aspects, as the statistics show, we are not a big player. European trade with Eastern Europe is considerably larger than ours. Europe's credit to Eastern Europe is considerably larger than ours. To some degree, this fact has to be taken into account.

But basically, it is still our view that even given this consideration, it would not be wise to give further credit to Poland, and to some degree to the rest of Eastern Europe, until martial law is lifted, and until an internal dialog is begun again in Poland. As Bob Hormats mentioned, we have reached an agreement with our allies that we will not give the Poles any official credits. At a very early stage, there was some indication that the Europeans would continue to grant official food credits, but after further discussions, they agreed not to give the next tranche of those credits. So we made some progress in bringing them along to our line that official assistance to this regime should be cut off.

I don't think one needs to say much about private bankers. I think anybody can see the debt situation. It is in the background paper. Just look at Poland, which has a 173-percent debt service on its $26 billion debt. That is an optimistic basis of what they would have to do if they used all of their exports plus to pay their hard currency debt. This is what they would need. So they are hardly somebody people are rushing to lend to. Syndicated credits or credits from any Western private banks are not going to Poland.

The Polish situation is having an effect, understandably on the rest of Eastern Europe. The whole concept of the so-called umbrella theory has been called into question, and their access to nonofficial credit has been curtailed.

So, the next question is, what should we do about the debt? Our feeling is that we should try to collect it. The more pressure we can thereby put on the East Europeans, particularly on the Soviet Union, to come up with funds to help Poland, the better.

That leads to the question of what can we use to exert the most pressure. It has been the view of the 500 private banks involved and of the governments involved that to maintain maximum leverage on the Soviet Union they should be held to the normal commercial concept that they owe this money, so they should come up with it.

Historically, the U.S. Government never declared a country in default because we want to keep the pressure on them to pay what they owe. If they had a substantial pool of assets sitting in the United States that we could attach we might declare them in default, and do it. But we know that the Poles don't have any.

We have, therefore, determined that the greatest leverage we maintain on them is to say, pay your debts right now. As Bob mentioned, we have agreed with Poland's other official creditors that we will not negotiate a rescheduling of their 1982 debt payments until certain conditions are met. These are that the banks must finish their 1981 rescheduling, which they will not do until they receive their interest payments, and until we are paid the amounts of money that were owed on the 1981 rescheduling which we provided—and there is the interest due on that—and considering what the situation is in Poland, economic and political, we are not rescheduling.

In this way we hope to maintain the maximum amount of pressure on them to try to roll back the actions of December 13th and to enter into an internal political dialog. Once that is accomplished, we will see what we will do to stretch out their payments. At the moment, however, we and our allies see little progress in this regard so we are con-

tinuing to maintain the maximum pressure on the Poles, and on the Soviet Union itself, to pay their debts to us.

Thank you.

[The Treasury and State Department statements follow:]

TREASURY AND STATE DEPARTMENT BACKGROUND PAPER ON POLAND'S FINANCIAL AND ECONOMIC SITUATION

POLAND'S ECONOMIC STRATEGY FOR THE 1970'S

In the early 1970's, Poland embarked on an ambitious economic development strategy to modernize its economy and to increase substantially its living standards. The strategy envisaged a simultaneous expansion in investment and consumption. This could only be undertaken with foreign borrowing, primarily from the West.

Massive increases in investment were needed to reorient the economy away from inefficient import substitution. Priority emphasis was given to investment in heavy industry, a strategy in which imports of capital equipment from the West figured prominently. Restructuring the economy also required the introduction of substantial inputs of Western technology to increase the overall efficiency of the productive process. Further, the Polish planners believed it was necessary to develop a viable export sector to enable Poland to sell its products in Western markets.

In order to achieve these increases in output and increased efficiencies, the Polish authorities felt that Polish workers needed added incentives to stimulate the growth of output. To this end, substantial increases were planned in both the quality and quantity of goods which were made available to the Polish consumer to render effective the enhanced monetary incentives which were offered. It was seen as particularly important to improve the diet of the Polish worker. Accordingly, a sharp increase in food production and food supplies, especially meat, were planned for by use of appropriate pricing incentives for the large private farm sector. In so doing, Polish authorities also hoped to avoid a repetition of the food riots of December 1970, and their disruptive effects on the economy and society.

The Polish planners believed that access to Western credits and technology would permit a rapid expansion of modern, competitive, efficiently produced products. These goods were to be produced in new, or newly modernized, plants utilizing modern Western machinery. They were to produce in accordance with Western standards, and in some cases, under licensing arrangements with the leading industrial firms of the West. In this strategy, it was expected that Polish products would be sold in Western markets and the trade deficit, which would be incurred to obtain the productive inputs from the West would soon shift to a trade surplus, enabling the Poles to repay their hard currency debts.

EARLY RESULTS

While the Polish economy registered some impressive gains in the early 1970's with real economic growth averaging 6 percent per annum. However, it became apparent by the middle part of the decade that the strategy was encountering major difficulties.

The main problems stem from the fact that Polish authorities made a number of policy errors. For example, when the Western recession began in 1974, most East European countries cut back their hard currency imports from the West. The Poles, however, like a number of developing and industrial countries, continued to adhere to their ambitious development plan and maintained a rapid rate of increased imports to build their new industrial capacity. As a result, Poland's trade deficit with the West widened. By year-end 1975, this deficit exceeded $2 billion. Between 1975 and 1980, Poland's cumulative current account deficit with the West amounted to a massive $18 billion.

Incorrect income and pricing policies were also responsible for Poland's economic problems. In particular, the Polish planners tried to insulate the economy from the inflationary pressures of the mid-1970's by utilizing subsidies, price controls, and taxes. These measures increased the degree of distortion which already existed in the price structure and exacerbated the financial situation of

enterprises as well. Ultimately, these distortions reduced the ability of productive sectors of the Polish economy to compete in world markets.

The recession of the industrialized Western countries impacted severely on Poland's economy, as it did on other economies which geared their growth in large part to exports to the West. For example, in the 3-year period 1971–1974, Poland's exports to the West increased at an average annual rate of 32 percent in nominal terms; in the period 1974–1977, exports increased at an average annual rate of 11 percent.

Contributing to these problems were Poland's export constraints arising out of inadequate marketing, servicing (including providing replacement parts), and advertising expertise. Also, the Poles did not develop a system of export incentives to induce managers to produce for export. The existing system favored domestic production because managers found it easier to meet planners' goals and obtain bonuses by producing for domestic consumption rather than meeting export goals which often involved more complex quality standards and were more difficult to achieve.

Poor harvests brought on by 6 consecutive years of bad weather and inappropriate agricultural policies compounded Poland's economic malaise. The emphasis on the expansion of heavy industry had resulted in a neglect of agriculture. Moreover, Poland's agricultural sector was highly vulnerable to poor weather.

The above elements combined to produce a 5 percent average annual rate of decline in real national income between 1979 and 1981, after 8 years of rapid growth. During this period Poland, and other Eastern European members of the Soviet bloc, ran large deficits with the U.S.S.R. The Soviets also provided subsidies to Poland and those other countries through sales of oil and raw materials to them at prices below world market levels. These subsidies to the Eastern European bloc members averaged $5–6 billion in the mid- and late-seventies, rising to $10 billion in 1979 and $22 billion in 1980.

POLISH DEBT ACCUMULATION AND DEBT RESCHEDULING

Beginning in the early 1970's, the Poles financed a large portion of their economic growth by borrowing from the West, enjoying relatively easy access to Western capital markets. As their development plans began to falter, they became less able to service their debt.

In 1972, Poland's gross hard currency debt totaled $1.6 billion. Its debt service, consisting of $200 million of principal and $74 million of interest, amounted to only 15 percent of its foreign exchange earnings from exports of goods and services to non-Communist countries. Poland's imports from non-Communist countries exceeded its exports to these countries by $1.3–3.3 billion annually between 1973 and 1979 as the authorities continued to pursue their development program. By 1979, Poland's external hard currency debt stood at $21 billion and its debt service ($3.6 billion in principal and $2.2 billion in interest payments) equalled 92 percent of its hard currency export earnings. By mid-year 1981, Poland's hard currency debt stood at approximately $26 billion. It owed roughly $20 billion of this to 16 western countries, $11 billion to official creditors or guaranteed by them, including $1.9 billion to the U.S. Government; and $9 billion of unguaranteed debt to private banks including $1.3 billion to U.S. banks.

At the beginning of 1981, it was estimated that Poland would require some $11 billion in hard currency financing to cover its projected trade deficit for 1981 and to service its debt. Poland was clearly not in a position to raise such sums and on March 26, 1981, Poland notified its creditors that it would no longer be able to guarantee payment of its external debts.

The governments and private banks responded to the Poles by agreeing to enter into debt rescheduling negotiations. Separate debt rescheduling exercises were organized by the official and private creditors. Fifteen official creditor nations (later increased to 16 with the addition of Spain) concluded negotiations with the Government of Poland and a multilateral debt rescheduling agreement was signed in Paris on April 27, 1981. This agreement serves as an umbrella agreement for subsequent Government-to-Government agreements to reschedule 90 percent of Poland's debt service obligations to these creditors both the principal and interest falling due during the last three-quarters of 1981. These obligations, totaling $2.4 billion, are to be repaid during a 4-year period beginning in 1985.

Interest on the rescheduled interest is to be charged during the grace period, 1981–1985. The United States/Poland Government-to-Government agreement was signed on August 27, 1981.

Western banks, moving on a parallel track, established a consortium to negotiate a debt rescheduling agreement with the Polish Government by September. The consortium reached an *ad referendum* agreement with the Poles for rescheduling 95 percent of the principal ($2.3 billion) of their debt falling due during April-December 1981, over 8 years, including a 4-year grace period.

The consortium of Western banks set a precondition for signing the document, namely that Poland pay *all of the 1981 interest*—an estimated $700 million—which fell due in the last 9 months of 1981. The Government of Poland could not completely fulfill this condition at year's end, and as a result, the Western banks did not sign the rescheduling agreement.

CURRENT STATUS OF POLAND'S EXTERNAL HARD CURRENCY DEBT

In 1981, in an effort to meet the condition of being current on interest payments to the banks, Poland made some payments to reduce its arrearages. In December, Poland requested that the bank provide a short-term loan which would be used to pay off remaining interest arrearages. This the banks refused to do, continuing to insist on repayment in full of all 1981 interest.

Official creditors agreed in November not to begin negotiations on rescheduling Poland's 1982 debt service until Poland signs its 1981 rescheduling agreement with the commercial banks. Following the imposition of martial law, the NATO Ministerial meeting of January 11, called for a suspension of consideration of debt rescheduling negotiations for the time being. The official creditors, including the United States, met January 14 and agreed that rescheduling negotiations will be held in abeyance.

(N.B.: In addition, the allies have stopped new commercial credits and restricted food exports, except humanitarian assistance, to Poland. The United States has also taken unilateral measures to put pressure on Poland and the U.S.S.R. We have suspended Polish airline landing rights and fishing rights. With respect to the Soviets, we have: suspended the sale of oil and gas equipment and technology; suspended action on validated export licenses for high technology; suspended negotiations on a maritime agreement; suspended Aeroflot service to the United States; postponed negotiations on a new grains agreement; closed the KAMA Purchasing Commission; and not renewed the scientific exchange agreement. Our allies have taken and are considering further actions to support and complement these U.S. measures, with the common objective of putting and keeping pressure on the Polish and Soviet Governments to permit the process of reform to continue in Poland.

In this regard, we and our allies agree that one facet of this pressure is to continue to try to hold Poland to its debt obligations to the West. This puts the Polish government under significant economic pressure. The suspension of consideration of negotiations on rescheduling 1982 Polish debt allows us to pursue the collection of those debts.)

OUTLOOK

Prior to the events of December 13, Poland's economic and financial outlook was extremely grave. GNP declined by about 15 percent in 1981, and shortages of spare parts and raw materials, because of the inability of the GOP to obtain Western financing, presaged even further declines without significant economic reforms.

The Polish Government, prior to the military crackdown, had designed an initial economic reform and stabilization program aimed at reversing the decline and eventually resuscitating Poland's finances. While progress was slower than many had hoped, that government and Solidarity were beginning a dialogue to bring about economic improvement. Such a dialogue is, in our view, the only way we believe that improvement would have been viable over time. According to the plan provided by that Polish Government to the Western creditors, in November 1981, Poland would work to balance its hard currency trade in 1982; and export surplus would have grown steadily in succeeding years. By 1985, the plan projected Poland's export surplus would be large enough to cover its interest payments, thereby eliminating the current account deficit and Poland's need to borrow in that year. After 1985, this plan projected a trade surplus large enough for the Poles to begin reducing their outstanding stock of debt. This projected

scenario would have required that Poland be able to borrow new funds from Western governments and/or banks until 1986 with the sums needed declining annually. The amounts it would have needed to borrow could have been reduced through continued debt rescheduling. The need for new financing would have been greatest in 1982. Even under this projection, Poland's debt service payments would have risen again in 1986 when the debt rescheduled in 1981 begins to fall due.

The Poles developed this projection before the imposition of martial law. Now it is quite difficult, if not impossible, to assess what path the Polish economy will take because of the repression of the Polish workers, whose support is needed for lasting economic improvement to take place, and the economic and social disruptions introduced by martial law.

Senator LUGAR. Thank you very much, Mr. Leland.

I would ask for unanimous consent that the factsheet which you have submitted be made a part of the record. They give us an important chronology and background.

[The material referred to follows.]

FACT SHEET ON POLISH DEBT

Poland has an external hard currency debt of approximately $26 billion; government and gover ment-guaranteed debt is some $17 billion; private unguaranteed debt is some $9 billion.

Of this amount, roughly $20 billion is due to 16 Western countries.

Polish debt to the United States totals some $3.15 billion, which is 14 percent of the total $26 billion.

The breakdown of this figure is:

	Billions
Nonguaranteed loans from private creditors (primarily commercial banks)	$1.3
Direct credits and guarantees by Commodity Credit Corporation	1.6
Export-Import Bank loan	.244
AID loan	.006

Governments of 16 Western countries including the United States, the United Kingdom, France, West Germany, Japan, Canada, Switzerland, the Netherlands, signed a multilateral agreement in April 1981 to reschedule 90 percent of the principal and interest falling due from May 1981 to December 1981. The U.S. share of this was $380 million. The official rescheduling totalled $2.3 billion.

Repayment terms provided for 4 years grace and 4 years repayment, the latter commencing in 1986.

These terms are generally comparable to those of other countries who have found it necessary to reschedule their debts.

In response to the Polish repression in December, the official creditors recently agreed to hold negotiations with the Poles on their 1982 debt service in abeyance pending a normalization of the situation. They also decided that in any event they would continue to adhere to their longstanding understanding that they will not discuss the 1982 debt until Poland signs a rescheduling agreement on its 1981 debt with the commercial banks.

The commercial banks of the 16 Western countries have been negotiating a debt rescheduling agreement with Poland.

The terms of this agreement as we understand them—providing for rescheduling 95 percent of principal only, $2.3 billion—appear to be comparable to those provided by Poland's official creditors.

It is also our understanding that the Government of Poland must pay all interest due to the commercial banks prior to signing of that agreement.

We have heard that this amount is now on the order of $250 million. We are in no position to comment one way or another as to whether the Poles will meet this payment.

Total debt outstanding to all banks is around $15–$16 billion; about $14½ billion was recorded as of June 1981 for those banks in the reporting system of the Bank for International Settlements. However, much of this would be guaranteed by creditor governments. After allowance for guarantees, the commercial bank debt is thought to be around $9 billion.

The precise amount of banks' guarantee-adjusted exposure in individual countries is reported regularly only for U.S. and U.K. banks (exposure in Poland of $1.3 billion and $1.0 billion, respectively, as of mid-1981). Around 60 U.S. banks account for the $1.3 billion, most of which report amounts equal to less than 5 percent of their capital, broadly defined.

Continental banks have a relatively greater exposure in Poland. The degree of exposure varies among individual banks. Some figures have appeared in the press, but we cannot attest to their authenticity.

As for 1982 maturities, we estimate that Poland's debt service obligations to official and private creditors for 1982 total roughly $10.4 billion—$6.8 billion in principal, $2.8 billion in interest, and $0.8 billion interest due on the rescheduled 1981 debt.

POLAND

[In billions of U.S. dollars]

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 [1]
Non-Communist:										
(a) Exports	1.8	2.5	3.9	4.1	4.4	4.9	5.5	6.3	7.4	5.6
(b) Imports	2.0	4.0	6.0	7.4	7.5	7.1	7.5	8.8	8.8	6.5
(c) Trade balance	−.2	−1.5	−2.1	−3.3	−3.1	−2.2	−2.0	−2.5	−1.4	−.9
Gross debt	1.6	2.8	4.6	8.0	11.5	14.0	17.8	21.1	25.0	26.0
Principal repayment	.2	.3	.5	.7	1.2	2.0	2.9	3.6	5.6	6.4
Interest	.1	.2	.4	.5	.7	.9	1.5	2.2	2.4	3.3
Debt service (as percent of exports)	15	19	23	30	42	59	79	92	108	173

[1] Estimate.

Senator LUGAR. I ask for unanimous consent that we restrict our questions to 10 minutes, and rotate back and forth. There are just two of us now, but there may be other Senators arriving shortly.

COORDINATED POLICY

In my opening statement, I cited Chancellor Schmidt in large part because I thought he made good sense at the breakfast meeting that he had with us, and also because he brings to the fore the point that my colleague, Senator Biden, made about coordinated policy. I understand, Mr. Hormats, you have been over there this weekend, working again with our allies in terms of a coordinated NATO position.

But the Western German position in this debt business is a very substantial one, as you pointed out in your papers, both of you, a great deal more than ours, and indeed the 500 banks encompass several nations. This is one time we are all in it together. It is not a question of starting from scratch and whether others want to join the activity; we are all there now, and involved in the activity.

Chancellor Schmidt made the point that a carrot and stick relationship might be useful to consider. As was pointed out thus far in all of our testimony, we don't know precisely what default means. As you said, Mr. Leland, it is not really a matter of historical record, and it is not certain what it means if a nation defaults in this sort of way. What we are after is collection.

On the other hand what we have all said in one way or another in background papers and statements is that the Polish economy apparently cannot operate without fresh money. Leaving aside the rescheduling of 1981 and the rescheduling of 1982, when the Solidarity leaders were here for informal meetings with members of the subcommittee

and Members of the Congress, estimates were made at that time for this particular year that about $9 billion would be required. Others said $6 billion, others said $16 billion.

The point that I am making is, just the raw materials for the infrastructure of any sort of movement would require a lot of new cash on top of whatever has to be rescheduled and repaid. Chancellor Schmidt and others have pointed out that this offers opportunities, because not only is that true of Poland, but it may be true also of other Eastern bloc nations, and a careful analysis of the economies of each of these nations would indicate that they are hard pressed each year on a net basis to generate new capital, given their current level of industrialization and capital activity.

So, the question that I would like for either of you to discuss, and it is not really a request to make policy off the top of the head, or to blue sky into areas where we all ought to take some time and thought, but doesn't this situation really offer us an opportunity in terms of foreign policy initiative to offer these sorts of choices? If in the future there is to be substantial new development of heavy industry, industry designed for consumer goods, anything that would lift the lifestyles and the quality of life for Eastern bloc nations, starting with Poland but rapidly maybe getting into the whole picture, as we have the umbrella theory expressed, is it worth something to Poland, to the Soviet Union, to see a standard of living rise for tens of millions if not hundreds of millions of people?

RISKS OF ACCOMMODATION

And if so, is it worth the experimentation and the risks of accommodation with our values which this would mean, unless we were so foolish as to extend the credit without requiring that there be any institutional change? In other words, I presume if we are so myopic as to say that Communists will always be Communists, and what happens in Poland is inevitable, and what has always happened is inevitable, and by golly, you just sort of deal with it, play the ball as it lies, and send the money in and hope for the best. I don't think we are going to play that game. At least this is one Senator who would not, and I don't think you are advocating that at all today.

You were saying, I think, that this offers an opportunity. Now, the other side, of course, is that the Soviets may very well say power is power. We really couldn't care less whether these people have any standard of living, and as a matter of fact, if they go straight down and we hang on, that is what the game is all about. I suppose that is another side of the coin, but we will not have lost any money in the process. We still will come back to them at some point and suggest it doesn't have to be that way.

I would like your thoughtful exploration of what sort of potential in terms of new policy thrust this opportunity presents.

Mr. LELAND. I think you are perfectly correct that the standard of living of the people of Poland is something that should be of concern to the Soviet Union as well as to the Polish Government. Clearly, however, before the events of December 13, what happened was that the Soviet Union, which had refrained from interfering directly earlier,

decided to take the risk, although they undoubtedly saw that it was going to be financially costly to them, not only in terms of the assistance for Poland and potential military action, but also in loss of Western credits.

They obviously decided that the liberalism in Poland had progressed too far, and they would have to pay that price.

STANDARD OF LIVING WILL DECLINE

Right now they are in a situation, as you correctly describe it, where the Poles can live without Western funds, but at the cost of a decline in their standard of living. How far can they let their standard of living drop? In addition, the only way they are going to be able to pay their debt to the West and thus get access to Western credits, is for the Soviet Union to come up with the money.

So, as you say, the Soviets are going to have to determine how much they want to spend in order to maintain the repression in Poland. I think our responsibility is to make them pay the maximum amount, we cannot determine, and I don't think they have decided yet, how much that will be. Basically, what we have to do is just say that so long as that repression continues, our private banks certainly aren't going to come up with money, and the governments have agreed that they won't.

Obviously, the possibility always exists that if they change their behavior—if they can set up a dialog and give the Polish people certain rights—the carrot will always be there. But I don't think at this stage we can really be too optimistic about its being used.

Mr. HORMATS. I would just add a couple of points. Essentially I agree with what Marc Leland was saying. At this point it is too early to determine what type of carrot might be put together. The President did indicate earlier, just after the declaration of martial law, that the United States could consider some support for Poland if the three conditions that were specified in his statement—elimination of martial law, release of the prisoners, and a genuine dialog in a free atmosphere—were restored. The United States might be of some assistance in those circumstances, but I think that is a very distant candle on the horizon.

POLISH ECONOMY SUFFERED MANY DIFFICULTIES

The Polish economy has suffered a number of difficulties over the last several years. Management of the Polish economy has not been as good as it might have been. Also, they have run into difficulties as a result of slower growth in the West, and there are a whole host of difficulties that they face.

What is probably needed first is to remove the martial law so that the workers who are now being repressed will have at least some incentive to produce enthusiastically for the future growth of Poland. It is quite clear from all our analyses and all our intelligence that under martial law, under this repression, there is no popular enthusiasm for anything that would involve a reconstruction of the Polish economy. People simply won't work under these repressive conditions, and understandably so.

That is the first thing. The second clearly is to eliminate some of the oppressive conditions that have been imposed on the Polish economy. The Polish economy, where it has been left to private initiative—for instance, in parts of the agricultural sector—has done remarkably well. The Poles have demonstrated their ability to produce, and much of their agriculture is produced in private areas.

The price structure in Poland has been distorted for a number of years. The exchange rate has been distorted. What the Poles need after the lifting of martial law is a plan which the Government—before martial law—was beginning to embark on, with support from the West, to get the Polish economy moving again. What they are going to need at first are just the bare minimums. They don't have enough spare parts, and that is causing a grinding slowdown in their economy. They don't have such things as corn to feed their chickens. Some of the bare minimums would be needed just to begin to get their economy off the ground. Until martial law is lifted, all of these things are going to be very difficult for us to provide and, I think, won't do any good unless the incentives are there. That means lifitng the repression.

ALLIES AGREE WITH ANALYSIS

Senator LUGAR. Do our allies agree with this analysis? Are we all in this together?

Mr. LELAND. I think that has been the big success in this.

Mr. HORMATS. Yes.

Mr. LELAND. At the beginning, our allies did not recognize as quickly the extent of Soviet involvement in the repression, but I think it is fair to say that they do agree with us on that now and have taken measures accordingly.

Mr. HORMATS. I think there has been a very impressive convergence of views among the allies on Poland. Although the press sometimes tends to focus on divisions, it is very instructive to look at how unanimous the allies have been in some areas. There have been no new credits for manufactured goods, no new credits for food other than food going through humanitarian channels, such as CARE or Catholic Relief Services; there has been suspension of debt rescheduling negotiations. I think this illustrates the fact that we and our allies are totally unanimous on our unwillingness to support this Polish regime as it is now.

Mr. LELAND. We are not in agreement with everything with our allies. For example, some say that if they forgo participation in the Siberian gas pipeline we should be willing to forgo sales of grain to the Soviets. I don't think that the two situations are the same, however. Our grain sales draw money out of the Soviet economy instead of putting it in. Moreover, a unilateral embargo of grain by the United States would hardly be very effective, because the Soviets could get it from other sources, given the world supply situation. Stopping the pipeline would be very effective in limiting hard currency flows to the Soviet Union.

Senator LUGAR. Let me add to that, Mr. Leland, and say that Chancellor Schmidt, as he ticked off the steps that we had taken, at least during his appearances here, indicated that he felt we had made

important gestures which showed the seriousness of purpose and sort of highlighted what we are doing. He also characterized each of these steps as having minimal value in the overall picture. He even went so far as to say that in the case of a grain embar[illegible] although that would be by far the most serious type of economic action we could take, because, as you pointed out, Mr. Leland, we have a very fungible commodity which flows almost as easily as money, even this had limited value.

ECONOMIC MEASURES

One point I would like to make, maybe in the form of a question, is this. In truth, even though there has been a great deal of speculation as to which of our allies might follow any of our economic measures, or what additional economic measures such as embargoes we might take, in fact, our policy, or at least a NATO policy, not just a U.S. policy, a NATO policy with regard to these credits is a pretty hard-nosed, hard line attitude, in essence.

If all of the nations that are owed money by Poland are saying, we haven't gotten 1981 rescheduled, we haven't even thought about 1982 rescheduling, and on down beyond that we haven't given the faintest thought to new cash, and we are looking to the Soviet Union or to somebody to pick up the tab before any of this moves, and we know that the Polish economy is going down like a rock in the process, and may be taking some other economies, Eastern bloc nations that might be bled, plus the Soviet Union in the process, and that we really have a very strong hand in this, that is a pretty tough policy.

I suspect that one virtue of this hearing, if this theory holds is probably to highlight the coordination and the strength of the NATO alliance, and the strength of this policy, and the possibilities that it has, but likewise to gain from your expertise what downside risks and difficulties that one attached to it. If it has recklessness and irresponsibility aspects, we want to hear that, too, but we really want to see what we have here, because that appears to me to be the policy that we have underway, and it is a pretty strong hand.

I yield to my colleague, Senator Biden.

Senator BIDEN. Thank you.

I would like to make it clear, Mr. Chairman, that I was not suggesting that we could in fact or should impose a grain embargo. What I am suggesting is that it is probably the strongest thing, assuming we could do it, assuming we could succeed in cutting off grain shipments to the Soviet Union, it would probably be the most severe economic blow we could deal the Soviet Union. I won't even say probably, but I am confident that it would be by far the most severe economic blow we could deal the Soviet Union.

The point I also wanted to make is, I know of no great effort even to discuss the prospect of being able to make it effective. Argentina is an overwhelmingly Catholic country. It has sympathies with the Polish people. There is greater opportunity here with Argentina than there ever was in Afghanistan. Canada is a NATO country, and there are opportunities there. But without getting into that any further, I just wanted to make the point that this sacrifice and commercial restraint is a two-way street.

Let me ask a couple of basic questions. First of all, how much of an independent player is Jaruzelski? How many shots can he call? Does

it make any sense for us to be putting pressure on him? Is he an independent player?

SOVIET PRESSURE TO DECLARE MARTIAL LAW

Mr. HORMATS. It is hard to answer that with total certainty, but I can give you a general assessment that based on some of the analysis and thinking that was done in some of our discussions with European officials. The general feeling is that he worked very closely with the Soviet Union prior to and during the imposition of martial law. It is quite clear that the Soviet pressure on him was enormous to declare martial law. The fact that the commanding general of the Warsaw Pact forces was in Warsaw at the time martial law was declared was clearly not an accident.

Our judgment also is that martial law was planned very carefully, in conjunction with the Soviets. People who were there at the time of the imposition of martial law have remarked, almost all of them, on the fact that at virtually the same time communications stopped, contacts stopped. There was a blanket thrown over Poland, so that the Solidarity leaders could not be in communication with one another, and the heads of Solidarity were identified well in advance of martial law and were arrested almost all at the same time.

It is our feeling that this was done in close conjunction with the Soviets, as I say, under pressure from the Soviets.

Senator BIDEN. Do we believe he could lift martial law tomorrow without the permission of the Soviet Union?

Mr. HORMATS. I think it is almost certain that he could not.

Senator BIDEN. I tend to agree with you. No, I don't tend. I flat out agree with you. Now, if that is the case, it doesn't make a lot of sense to offer carrots or sticks or anything to the Polish Government. We have just established that it is this administration's position that he does not have a free hand in calling the important shots. He is not going to be the one to determine whether or not martial law is lifted. He is not going to be the one to determine whether or not Solidarity prisoners can be let out of prison. So obviously it is the Soviet Union that we have to get to in order to accomplish that end.

Now, let me understand the second point, which is that absent the Soviet Union giving the green light to the Polish Communist Party, the Polish military, to accede to the conditions that we have set for rescheduling and/or in any way financing the Polish economy, we expect to withhold any further credits or cash flow to the Polish Government.

In turn, I assume, or if I understood you correctly, we expect the Soviets to come up with the payments that are owed to the Western economy. Is that right?

SOVIET ASSISTANCE TO POLAND

Mr. HORMATS. No, sir. I think it is important to make a distinction. The Soviets over the last several years have provided and continue to provide the Poles with a considerable amount of assistance. That assistance—we don't know for certain, was perhaps around $6 billion last year. Much of that assistance was really designed to finance exports of goods from the Soviet Union into Poland, or conceivably to finance other goods from COMECON countries into Poland.

Now, we do not have any evidence that the Soviets are giving the Poles money to enable the Poles to pay Western owed debt.

Senator BIDEN. That is the point I am getting to. My understanding is just what you said. So that it is understandable to the folks in this country, there is no evidence that the Soviet Union is giving hard currency to the Poles, who in turn will pay their Western debt. We have also established that there is no possibility, martial law, or no martial law, of the Poles being able to pay any of that debt in light of the state of their economy at this moment.

Mr. HORMATS. It is important to recognize that the Poles do earn a certain amount of hard currency through their exports. We have the figures somewhere, but the Poles do export a number of things to Western Europe, such as coal, for example.

POLISH EARNINGS FROM EXPORTS

Senator BIDEN. Yes, I understand, but in terms of percentages, what are we talking about? Assume that every bit of the hard currency they earn from their exports goes to paying off the debt. What kind of debt can they pay?

Mr. LELAND. Well, it depends. Before martial law was invoked, we already saw changes. The people were working more. They were tending to produce more. As Bob said, they were privatizing the economy, and the certain parts of it that were privatized were doing very well. There were exports of $6 billion a year.

Senator BIDEN. Excuse me. In the last year?

Mr. LELAND. In the last year, there were hard currency exports of $6 billion. Now, if you count principal and interest in 1982, they will owe $10 billion. That is why I said earlier that their debt service ratio was very high.

Senator BIDEN. I understand, but were they in fact even paying the interest? How much of the interest on the debt did they pay in the calendar year 1981?

Mr. LELAND. In 1981, given the fact that payments have still been coming in, there is about $200 million, $250 million left to the private lenders. The official debt was rescheduled. The agreement called for rescheduling of 90 percent of the principal and interest. They were to pay 10 percent. They actually paid about 5 percent. But of course earlier they were trying to build up their economy, and as you remember, they came to visit us. They saw you. They saw us. We were all trying to push that.

Senator BIDEN. Yes, I understand.

POLAND CRUCIAL TO SOVIET UNION

Mr. LELAND. But if somebody had said, wait, we want you to use that to pay your debt, they could have paid some of it, certainly all the interest and some of the principal. Everybody agrees that the problem now is, how do you get at the Soviet Union? Martial law is not going to be lifted without at least the Soviet's consent.

However, we can get at the Soviet Union to some degree through Poland. Poland is crucial to the Eastern bloc countries' economies.

That is why they give it so much support. And to some degree it goes back to the same old question. The Poles allies are not giving them the money directly to pay the debt, but money is fungible. Any contribution frees up other moneys that the Poles can use to pay off their debt.

Now, last year their GNP went down 15 percent. There is a level at which the Polish people will not tolerate a lower standard of living. They can't just ignore entirely what happens to the Polish economy. That is why they have been giving them all this assistance, and why they are going to have to give more.

Senator BIDEN. But haven't they in large part been giving them all this money because that was sufficient to enable them to be able to meet their purposes with regard to Poland, which basically are twofold? One is to maintain the supremacy of the Polish Communist Party, thereby retaining and providing for the strategic and military link between the Soviet Union and East Germany, which they are incredibly concerned about, far and above anything else that we discuss here, but now, they have played one of the several cards in their hand. They have taken the chance of brooking the wrath of the world by stepping forward and having the heavy hand of the Soviet Union clamp down upon the Poles.

So I am concerned that since they already made their play, my question is this: Would it not be as likely that they would let the other mailed hand drop upon the Poles, which may very well be their physical presence, which would accomplish their purpose? They can in fact—according to our intelligence community and our military—meet their two goals one of two ways, either have the Poles do it, and or physically impose it, regardless of the standard of living of the Poles.

Mr. LELAND. If their concern were only Poland, that would be correct. The problem is, they have many concerns. Part of the reason why they didn't act earlier was that they were concerned about jeopardizing their relations with Western Europe, particularly regarding the pipeline. Even as strongly as the Europeans are reacting now, the situation would be far worse if they invaded.

In sum, they have other international interests at stake when they are dealing with Poland.

Senator BIDEN. Running the risk of appearing to be a bit facetious this would suggest that the administration acknowledges there are some small benefits to détente.

Mr. LELAND. I don't see the connection, Senator.

SOVIETS MODIFIED THEIR BEHAVIOR

Senator BIDEN. Well, let me explain it, because the connection is very important. You just said that the Soviets have modified their behavior because of their desire to continue to reap the economic benefits of a relationship with the West. Détente was premised upon the point that an economic relationship with the Soviet Union would, in fact, establish those kinds of relationships.

Mr. LELAND. But the point is, there is martial law in Poland now. They didn't go that far as long as they could get what they want.

Senator BIDEN. Right, but your point is, they will not do what they could do to accomplish their ends in Poland if they can get away with it.

Mr. HORMATS. Their preference certainly is to do it without having to go in. Martial law really is their vehicle for suppression, which enables them to avoid any direct intervention with a mass of Soviet troops.

Senator BIDEN. What if martial law fails, that is, fails in the sense that it does not meet the Soviet objective, and they are forced to move to take the next step of direct or indirect intervention?

Mr. HORMATS. It is very hard for us at this point to answer a question of that sort.

Senator BIDEN. Let me ask it another way, the same way I asked it in January of last year to this administration. Do we have, and I don't even want to know what it is, and I don't suggest that you state it publicly, but do we have a consensus among our allies as to what we will, in fact, do specifically if that occurs?

Mr. HORMATS. The answer is that the allies for the last many months have been working together to develop plans for just that type of contingency.

Senator BIDEN. But they haven't developed them yet, have they?

Mr. HORMATS. Yes; there are now a number of measures which we call measures on the shelf, which would be pulled off the shelf if there were an invasion.

FOUR STAGES OF SOVIET INTERVENTION

Senator BIDEN. With all due respect, that is what you all told me last year about plans being on the shelf, if there were the first and second moves. We always talked about four stages of Soviet intervention. One was to get the civil arm of the Communist Party to lay the law down. Two, if that failed, we thought the next thing that would happen would be that martial law or the Polish military would be called in. Three, if that failed, we said there was a prospect of the Warsaw Pact being used, and four, if that failed, we said, what would happen was direct Soviet intervention. We were told that there were plans on the shelf for each and every one of those alternatives, yet I sat with Chancellor Schmidt for 4½ hours at dinner the night he was here, and for an hour and a half at breakfast, and he said you all never talked to him about any of those things other than the last prospect, the last option.

Mr. HORMATS. It will not serve our purposes to get into a debate on what the Chancellor said. What was done in the period of months before this was to work out a plan for the contingency of an invasion. It was fully recognized during this planning period that there were a number of "gray areas," a number of possibilities. This could have occurred in several ways. It was felt that it would be very difficult to develop any predetermined set of responses because within that gray area there were many possible permutations, and it was very difficult to plan precisely what we would do in the event of each of those. But there were a number of measures discussed.

In fact, when this did occur in December, there were a number of consultations with our NATO partners.

Senator BIDEN. Before we announced any of the sanctions?

Mr. HORMATS. Yes. As a matter of fact, Assistant Secretary Eagleburger went to a number of European capitals. Mr. Leland and I spoke to a number of our colleagues informally.

Senator BIDEN. This is not an unimportant point, at least to me, because it would be very helpful for me to know the answer to this. Were our European allies specifically notified of what sanctions we were about to impose in advance, the specific sanctions we in fact imposed, in advance of our imposing those sanctions?

Mr. HORMATS. I cannot sit here and tell you that we went over every sanction with every ally.

Senator BIDEN. But there weren't that many sanctions that we imposed.

Mr. HORMATS. Well, there were a number of specific ones. I didn't go with Mr. Eagleburger, so I don't know precisely what went on in his discussions, but my strong impression is that he gave the allies essentially two things. One was our analysis of what was happening in Poland and our concerns about this, and the other was a general sense of what we intended to do. I do not know whether he went into detail on each of these.

Senator BIDEN. My understanding, and it would be useful for the record, is that our allies were not told in advance of the announcement of the specific sanctions, what those sanctions were going to be.

Mr. LELAND. I would like to back up Mr. Hormats. We all had consultations with our counterparts in Europe; he did, I did, and so did Larry Eagleburger. As a result, they were certainly aware—and pretty specifically at that—of the nature of the sanctions which we later instituted.

Senator BIDEN. I am not suggesting that that was not the case, but I do suggest there is a difference between a head of state in a foreign capital picking up a newspaper or hearing a news broadcast announcing that X, Y, or Z was done today prior to having been informed that X, Y, or Z was about to be done. I don't think that is insignificant.

Mr. HORMATS. Let me speak to that. One was a set of consultations in which Larry Eagleburger went over our analysis of the issues and gave them a general sense of what we were contemplating to do. So far as I can recall, virtually all of our allies, and a number of countries who are not in the NATO alliance but are concerned about the issue, were given advance notice of what was announced by the President.

Senator BIDEN. Advance notice in terms of what?

Mr. HORMATS. Advanced in terms of hours, the details of it. But this comes after what I consider to be a relatively thorough discussion of the issues.

Senator BIDEN. Well, why I asked the question is obvious because the next series of sanctions, if in fact there are going to be any, assuming things further deteriorate in Poland, obviously or hopefully are going to be more than stopping Soviet commercial flights into Kennedy Airport or cutting back fishing rights.

I assume that you all are going to do more than that if the President will back up what he says he will do, so obviously there will be greater repercussions, whatever they are. I would just suggest to you from one Senator's perspective that it would be incredibly important that well in advance of our doing it, the other capitals of the world are fully aware of precisely what they are so that they stop bludgeoning us with the reed that is only a reed and not much of a bludgeon but one which they always reach into their quiver to grasp—and that is a horrible metaphor—one they always reach for, and that is they save themselves from having to face the tough problems. They save themselves from having to address the tough issues by saying, "well, you didn't talk to us."

I would like to take that argument away for once. I am so tired of the Carter years where we didn't tell them anything, of coming along and saying: "OK, Chancellor Schmidt, we are going to do, A, B, C and D; you now know, what do you think about it?"

Mr. LELAND. There have been a lot of consultations on this issue, Senator, so that error wouldn't be repeated. Secretary Haig visited Europe, there are intensive consultations going on in NATO, the group of creditors that got together on the 15th and 16th discussed the financial issues—you couldn't have much more extensive consultations. We recognize as I said in my statement, and that we are not the only or even the major player in terms of economic stakes.

Senator BIDEN. I understand that and I don't want to belabor the point. I would just suggest that there is a difference between consultation and arrival at a mutually aceptable decision. I can consult all day with my colleague from Indiana. I can discuss every single, solitary aspect of the issue, whether it is Poland or SALT or wheat or whatever it happens to be.

I can let him know what my inclinations are. But, if I don't say to him: "By the way, Dick, I am going to walk to the floor in 5 minutes and I am going to introduce a bill that calls for an embargo of wheat" or that calls for whatever it happens to be, that doesn't do me much for my relationship with Dick. As a matter of fact, it may hurt it and not help it because he would be led to believe by my taking all the painstaking effort to go into all the detail about the issues and then not tell him what I was going to do, that somehow he had been led down a primrose lane.

So if you did it before, wonderful; do it again. If you didn't do it last time, pray God, do it this time.

My time is up.

Senator LUGAR. Thank you, Senator Biden.

CHANGE IN WESTERN BANK CREDITS

Let me ask a quick question and then a more general one. First of all, what do you now note has been the change in terms of Western bank credits, new money to other Eastern bloc nations since the martial law was imposed in Poland?

Mr. LELAND. Well, getting the specific information on each one is not easy. The official creditors have agreed to stop lending there, and

we do not know of any syndicated loans. There doesn't appear to be anything other than short-term credits. On the contrary, there appears to be a flow of funds back toward the West, that is, net repayments of debts.

Senator LUGAR. That would be true, then, specifically of Hungary and Rumania?

Mr. LELAND. The Eastern bloc in general.

Mr. HORMATS. I think it is important to differentiate among the economies of Eastern Europe. Clearly Poland has an enormous debt, and as Marc says, an enormous debt-service burden. Other countries have run their economies and their debt portfolios in a somewhat different way.

You have Hungary, which for the last several years since the reforms of 1968 has begun to "marketize" its economy—to allow market forces to develop within that economy and to diversify; there is a lot more decisionmaking at the plan level. They also have been very prudent in terms of their borrowing. They run their foreign exchange portfolio very well.

You have Yugoslavia, which is really not a member of the Eastern bloc, not a member of COMECON, and while they have some economic difficulties, to be sure, they are still trying to manage their economy in a way which is consistent with their international obligations.

So I think it is very hard to generalize. Banks are generally taking a more prudent attitude, but I think banks also differentiate among these countries on the basis of the quality of the economic management of the country. The circumstances are different with respect to different countries.

The Soviet Union, is normally able to borrow when it wants to but is seen by most banks as a credit risk right now. It hasn't actually borrowed all that much because during the last several years it has maintained a current cash surplus or only a small deficit. So they are all quite different and unique in character.

Senator LUGAR. Even if that is true, are you still saying it is true that circumstances have not changed since mid-December? In other words, if you were a stockholder of a bank in the United States or maybe in Germany or Great Britain, and your bank was thinking about loaning money to somebody in the Eastern bloc now, would you be very sanguine about that idea?

Mr. HORMATS. There has been a greater degree of prudence and perhaps caution in lending to Eastern Europe, not just since December but throughout the latter part of last year. As a matter of fact, bank exposures in many countries of Eastern Europe have really been going down over a period of a couple of years.

Senator LUGAR. I would ask this, I suppose, of a private banker, from your perspective, why would a bank in the United States want to loan money to any Eastern bloc country at this particular time?

Mr. LELAND. It is unlikely that they would, unless they were making a grain sale on 30-, 60-, or 90-day terms in support of continuing sales. We don't believe they would want to make any syndicated loans, and all of our information leads us to believe that they are not doing so.

"BUSINESS AS USUAL" CREDIT EVALUATION

Senator LUGAR. You know, from time to time in hearings such as this, we have had bankers, either in this committee or in the Banking Committee, indicate that they have a large portfolio of exposure. We have wondered, how do you know you are going to get repaid from all of these situations?

They have said, well, you know, you would be surprised how well it is all going, and besides, any one part of this very small part of the portfolio is a risk that you take. But now here we have a situation in which people aren't getting paid from Poland. It doesn't look like they are going to get paid for a while.

It calls into question, it seems to me, the "business as usual" credit evaluation, even with regard to the Soviet Union. One can say it is a big country and surely must have the ability to pay at some point, but in terms of private funds, if any of the four of us in this dialog today wanted to loan money to the Soviet Union, would we really feel certain we would get repaid as opposed to loaning money in the United States, for instance?

I really think this is a question that needs to be examined as to why any loans, as a matter of fact, would be made aside from something where, as you say, you would be dead certain to get your money back in 30 or 90 days because of quick turnover, if such a thing is conceivable in those kinds of relationships.

Mr. LELAND. I think that is true. As Bob said, I think that is why the banks even before this event began reducing their exposure.

Senator LUGAR. Is any planning going on? I share my colleague's questions with regard to contingency planning in terms of other things that the Soviets may do with regard to Poland. I think the on-the-shelf things suggest to me, unless you have a different interpretation, that although there are a number of things that have been listed as an acceptable procedure, even then our allies and we have not necessarily all come down and said that we would do them. Isn't it a fact, that we have said there are a number of hypothetical things that might come up, and that opposed to going through the whole gamut of 50 things, you draw off the shelf half a dozen and see whether anyone will raise a hand to support those?

Mr. HORMATS. It is true that there is no guarantee that everyone will do everything that is on the shelf, but having participated in a number of those meetings, I think there is at least a strong presumption that in the event, for instance, of an invasion, most of them would be introduced by most countries. There are countries in the Alliance like Greece, which I suspect would perhaps not participate enthusiastically in some of these steps, but most other countries, I suspect, would go along with them in the extreme circumstance of an invasion.

PLANNING MECHANISMS WITH WESTERN NATIONS

Senator LUGAR. So this is our preparation of the sticks. Now, with regard to potential carrots, what is the planning mechanism, or is there one now, with the Western nations to think through specifically what sort of conditions would have to happen in Poland if in fact credits were to be forthcoming again.

Now we have had the recitation, I think, with regard to almost all of our policies, three initial conditions would be required: the end of martial law, the freedom for those who have been imprisoned, and some unspecified degree of negotiations between the government and Solidarity and the Catholic Church or other parties.

Let's say that martial law was ended and the prisoners were freed and some talks were going on. Surely we are not going to loan money unless we have a fair idea of how basic institutions in Poland are going to use that money in a way that is likely to produce profit as opposed to loss. That requires a liberalization which is substantial, you know, maybe even beyond where we were last December.

You may very well argue, as you have, that that may not come about for awhile, and I wouldn't disagree with that. All I am saying is have we begun to put on paper or to visualize those circumstances so that if, in fact, it was ever interesting to anyone again to want to lend more fresh money, is it clear what the conditions are and how reforms are to be implemented?

Mr. HORMATS. Since martial law we have not put down on paper the sort of economic plan that Poland would have to follow in order for us to supply additional sums of money. Prior to the imposition of martial law, when there appeared to be the beginnings of a dialog between the premartial law government and Solidarity on economic reform, we had had a number of exercises going on both internally and with some other countries on economic developments in Poland and on steps which could improve the economic outlook and which would warrant additional sums of money.

What I would envisage doing, if we got to a time when we could see the end of martial law, or even before that, conceivably, would be to think about how we could begin to dust off these exercises and build on the discussions which we already had. I take your suggestion. I think it may be a distant point but a point, nonetheless, which we hope we will get to in the future. It is worth discussing within our Government and with our friends and allies.

GUIDELINES MUST BE SET

Senator LUGAR. Well, whether you do so openly or behind closed doors. I would just say that I think it is imperative that that happen now. I don't think it would be useful to say that down the trail, if martial law is lifted, we will then consider options but should be doing so now. We could be badly surprised. What if suddenly the general says we are lifting martial law, which is what you folks wanted, and we have a lot of Polish people who are badly suffering, and why don't you send us the money, why aren't you moving on this? And we would say, well, we hadn't expected that that would happen quite that fast, and as a result, we are going to think about what the conditions are, we don't have our list ready.

You know, right now we ought to be saying, if we believe in freedom and in free people and in collective bargaining and in liberalization and in market systems and what have you, this is what we want, this is the kind of system that might produce credits that might get somebody repaid, but it won't do for you to simply lift martial law and present us a bill. I can just see us getting trapped into that kind of reactive posture very rapidly, which is the sort of thing we don't want to get into.

Mr. HORMATS. I think it is a very fair point. As I said, some work had been done prior to December, but I think your advice is good and it is worth our going back and thinking about how we can develop another exercise for the contingency that something favorable might happen.

Senator LUGAR. Senator Biden.

RESCHEDULING DEBTS

Senator BIDEN. Thank you. I would like to pursue three somewhat different points. First, back in 1977 or 1978 I, with the significant assistance of John Ritch, a professional staff member on this committee, wrote a report for this committee regarding the debt which Eastern European countries owed to the West and the implications of us not paying more attention to it.

We are talking about Poland today. Back at the time that report was written or since that time, Bulgaria is the only country that has not significantly worsened its debt ratio. East Germany, in terms of net hard currency owed to the West, has increased that by about 30 percent, Hungary by about only 10 percent, Poland by 50 percent, Rumania by somewhere on the order of 60 percent.

The point is this is not the only outfit, Poland is not the only country in that position. There is discussion that Rumania is going to have to talk about rescheduling its debt. I am not sure how far behind, if very far behind, Hungary and Czechoslovakia are. To follow on the point that the Senator from Indiana made, what do we do in terms of U.S. policy about the direction that the debt ratio is moving in every one of these countries? Is there an overall game plan?

Mr. LELAND. I think, as you pointed out earlier, there are a lot of similarities and there are a lot of differences. We have extensively analyzed Poland's debt situation and how it developed, as is shown in our background paper. Hungary is in a different situation. Rumania, as you say, has even more problems, of which we are all aware.

The private banks, as we have already discussed, have loaned partially on the basis of the umbrella theory, figuring the Soviets would have to pay. They need the trade.

Senator BIDEN. That they, the Soviets, would have to pay.

Mr. LELAND. The Soviets would have to come up with the money—sell gold, increase their exports or cut their imports, and lower their own standard of living—to get the hard currency to pay those debts. Because of the Polish situation, the bankers may understandably be changing their attitude as to how much they could count on the Soviets. Now they may look more closely at what is going on in those countries to determine whether they will be repaid.

GROWTH OF DEBT RECOGNIZED

So, obviously the events in Poland, and even prior to that, the growth of the Poles' debt was recognized and the private banks already were to some degree pulling back. They were trying to reduce in their exposure. This is a problem that exists as well in ordinary private debt. When someone owes you a lot, there is a tendency to lend more to keep them going as long as you can keep getting money back from them.

Senator BIDEN. Well, my experience is that occurs even sometimes when you are not getting anything back. An awful lot of loan officers

have gone down the tubes that way, you know, financing enterprises where they have a big chunk in that they are not getting anything back, but there is the constant self-delusion that if I just give them a little more, they will get on their feet.

Is there any indication that in light of the energy situation and in light of the type of growth in the various economies, that the Eastern bloc countries are going to be able to be in that position in the near future?

Mr. LELAND. I think there is extreme caution in lending being given to them.

Senator BIDEN. Let me get specifically to Poland. According to the factsheet you gave us, Mr. Leland, and I don't have any disagreement with the facts you have set out here, the debt service as a percentage of exports for the Polish Government is 173, up from 42.

Let me ask this question. Even if the Polish Government did not import a single additional item from the West, is there any prospect of its being able to make good the debt as it is presently structured?

Mr. LELAND. Well, I think we discussed that to some extent earlier. When we looked at the rescheduling of the 1981 payments, we recognized that the possibilities were slim in the next few years. That is why we arranged the rescheduling with a grace period.

The potential, for repayment I think everyone recognized, was there. Poland has a well-trained, well-educated work force. They have substantial potential natural resources. If they followed the proper economic policies, they had the potential to improve, but in the short run they have not. I think you would have to say any loan officer looking at the situation now with 20/20 hindsight would say many of those loans should not have been made, the umbrella theory notwithstanding.

So, I think it would be to difficult to try to project whether several years out, their economy will recover sufficiently to the point where they could repay their debts.

REASON FOR SOLIDARITY

Senator BIDEN. Some have argued that one of the strongest reasons for the rise in the popularity and power and influence of Solidarity in Poland was the precipitous, continuous decline in the Polish standard of living at bread and meat lines and the like had something to do with it, that it didn't start off to liberate the Polish society, to bring out freedom of the press, to fundamentally alter the political game plan; that it was born out of a continuous and precipitous decline in the standards of living.

Do you agree that that was one of the elements in the rise of Solidarity as a political force?

Mr. LELAND. I think it was an element. I would also add to that, however, that all kinds of freedom—whether freedom of the press or some other—are important to improve the level of how people live. Without those freedoms, it is unlikely they will be able to do so.

Senator BIDEN. I am not trying to make an artificial distinction here. What I am trying to get to, to be sure that I understand is this. If I understand your position—and I think I agree with you—the only way that the standard of living in Poland will not further deteriorate, and the reverse, have any prospect of improving, is if two things happen. One is if the Polish economy and the market system is restruc-

tured. Part of those are liberation of the political structure. In a sense you just made that distinction.

So, one thing that has to occur is a change in the market structure of the Polish economy, which would, in fact, take its political toll upon the Communist apparatus and the Communist structure as it is presently in place in Poland.

POLISH STANDARD OF LIVING PROSPECTS

The second thing that would have to occur would be simultaneously an infusion of capital from the West. Absent both of those things happening, there is no prospect of the Polish standard of living doing anything but continuing to decline. Is that correct? That is, no reasonable prospect.

Mr. LELAND. Well, let's go back prior to December 13, Senator. The Poles did need infusions of capital because of the seriousness of their situation. I agree that getting their economy and their society, as you put it, in order, are prerequisites for an eventual improvement in their standard of living.

Now, when you will have that improvement and over what timeframe you can expect it to occur is another question. You may have to accept a lowering before you can have the raising.

Senator BIDEN. I understand that, but the reason I bothered to ask the question is to be sure I understand the two things that have to happen. It is because our foreign policy decisions hinge upon our view of what is going to bring about a change in Poland to our liking and to the liking of the Poles.

It seems to me that the one thing that our foreign policy establishment continues to hold fast to is that there is no reasonable prospect that the Soviet Union will allow a circumstance to occur in Poland which would in effect challenge the supremacy of the Communist Party.

We have been told, and I fully agree, from the outset that once Solidarity moved to the position of being an equal or a direct threat and/or the Catholic Church a direct threat to the supremacy of the Polish Communist Party, that is when the action would start. You know, I am not really trying to be argumentative; I am trying to figure this out for myself.

If, in fact, we hold the view that acknowledges that the Soviets are not going to let Solidarity move into a position that it either had reached, in their opinion, or was rapidly approaching, which was designed by Solidarity to have a say in what the market forces in Poland would be, how they should be arranged, what the work force should and shouldn't be and what the priorities of the Polish economy should be, if we acknowledge that the Soviets are not going to allow that to occur and then on the other hand we premise our conditions and responses to Soviet actions and Polish actions on the assumptions that they have to change the market system, they have to change the way in which they run the show before they can get the infusion of capital from the West or from wherever, it seems to me we are saying that we are expecting what we have acknowledged cannot occur.

Mr. HORMATS. Senator, I think you have raised a key point in this issue. We have never really tried to tell the Poles how to work out their economic problems in the sense of intervening in their domestic economic dialog. In our judgment, there was a dialog on the economy between Solidarity and the Government of Poland, and toward the very end there was a three-way dialog among Solidarity, the church, and the Government. They were moving to continue the reform process and work out an internal solution in Poland which was relatively acceptable to all three of the forces there.

What has happened is that the Polish Government has suppressed that dialog by the declaration of martial law.

Senator BIDEN. The Soviet Union.

Mr. HORMATS. The Polish Government, with the support of the Soviet Union. As I said at the outset of my statement, the Soviet Union is directly involved and pressed the Polish Government very hard to take these actions. The problem now is how to get the dialog resumed again in the direction that it was moving before. We are not in a position and we wouldn't presume to tell the parties how to work out the proper balance among them. That is a Polish issue and a Polish decision, not an American one.

It seems to me, however, that we do have a very strong interest in pressing them to resume that dialog, to resume the process of reform, and let it work itself out in a reasonable way. That is what has been cut off totally by the imposition of martial law. How that will come about is something we can't predict. But we want the process of liberalization and reform to begin, and in earnest.

It seems to me that one of the things that was beginning to happen before martial law was that they were coming to realize that they had to get together on some type of economic reform plan at the same time they were moving toward a political reform plan. Now, they hadn't put this in concrete. There hadn't been any final decision, but there was recognition of the need. There were Polish economic leaders who came to the West, there were Polish leaders of Solidarity who both acknowledged that that was needed, and that it needed to be worked on. I think if the process is allowed to resume, if the repression is lifted, then they can work out a balance which deals responsibly with these issues. It may take time, and during that period of time we may need to provide a certain amount of assistance to allow that process to evolve, but it seems to me that is really what we should be aiming toward.

Senator BIDEN. Are we inclined to allow that process? Let's take a hypothetical. Let's assume Walesa was released, and then was willing to reinstitute that dialog, and in return for that Walesa said to the Polish Government that he would in fact not support Solidarity moves that related to issues unrelated to the economy, such as freedom of speech, you know, all of the things we feel fairly strongly about here. The offshoots of the economic questions. I mean, you can have a market system without freedom of speech, unfortunately.

If he did that, and the dialog was reinstituted, but did not meet the demands that I think a lot of my colleagues are calling for—it is

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not merely that their economy get back into shape, but that there be some real liberalization of freedom in Poland—would we still be willing to go forward and negotiate with them?

POLITICAL LIBERALIZATION PARAMOUNT ISSUE

Mr. HORMATS. In trying to answer your question, I was really talking about both. I was talking about the political liberalization process, which seems to us to be the paramount issue at this point.

Senator BIDEN. I just want to be sure what our aim is.

Mr. HORMATS. Absolutely.

Senator BIDEN. I am not quite sure how realistic that is, quite frankly.

Mr. HORMATS. Well, there is no possibility of our providing now the sort of assistance that had been discussed earlier while the repression exists and while a political dialog toward liberalization in a free atmosphere is suppressed.

Senator BIDEN. So what we are really saying to the Soviet Union is, before we get into this, you are going to have to allow Poland to be the freest, most open society that exists behind the Iron Curtain. That is what we are saying to them.

Mr. HORMATS. Those are your words, Senator. I do not disagree with them as an objective. As a matter of fact, I will agree with them as an objective.

IMPACT OF TOTAL DEFAULT

Senator BIDEN. Let me move to one other point, and then yield again. Have we analyzed in the Treasury Department, in the State Department, or anywhere in our Government independently what the impact upon the French, the Germans, the British, the Benelux people, the Italians, et cetera, have we independently analyzed what a total default on the debt would mean to their economies?

The reason I ask is this. What happens when I discuss the issue with Europeans is, they give me figures and numbers that are very ominous from their perspective. They use that as an argument to suggest that somehow we have to be engaged in sharing that burden. I am a skeptic by nature. I am not sure when the Germans tell me that default on the loan would jeopardize the German banking system, default on the loan would, in fact, cause unemployment to rise to x percent. Do we have an independent analysis? I am not asking you to tell me what it is, but do we have an independent analysis of what we believe the effects would be upon European economies if in fact there were a total default on the Polish debt?

Mr. LELAND. Yes.

Senator BIDEN. Good. [General laughter.]

I will ask you in a closed session to share that with us, but I will not ask you to do that right now. Thank you.

Senator LUGAR. Senator Biden, if you have further questions, please go ahead with them.

Senator BIDEN. I do have two more questions, Mr. Chairman. Thank you.

SAFETY NET APPROACH

Have we discussed, in light of the fact that we have made an independent judgment, have we discussed with our allies, to steal a phrase from two administrations back, any safety net approach as to how in fact we would be able to or if we would cushion the blow which would fall much more seriously upon some of our allies than others? Have we had any discussions with our European friends as to how we are in this boat together?

Mr. LELAND. Yes.

Senator BIDEN. Good. Have we reached any consensus? Is there a consensus within the administration as to the need for us to possibly take a bigger bite out of that bad apple than we are financially bound to do as a consequence of the loans that are outstanding to the U.S. Government and American banks?

Mr. LELAND. I think that there are so many variables involved with the first "yes" that, to go into an answer to that question presumes an answer to the first one. As you said, it really isn't appropriate to go into that here. I think the answer is that it certainly is something that we are discussing in general. Everybody has different obligations throughout the world. We all do. We have different levels of defense budgets. We all have different levels of social budgets. We all have a variety of things that are involved here, and there are a lot of contingencies of what could go on.

Given this, trying to build a consensus on every one of those possibilities would not be particularly useful.

CONSULTATION ON POLISH SITUATION WITH THE VATICAN

Senator BIDEN. My last question is this: Have we discussed and/or had consultations regarding the situation in Poland with the Vatican?

Mr. HORMATS. Yes; we are in very close touch with the Vatican. We give them, I think, advance notice on virtually everything we are doing. We share a good deal of information with them. In particular, we have been working with the Vatican, with the church, on the issue of humanitarian food assistance to Poland, because we are going to have to rely heavily on the church distribution channels.

Senator BIDEN. There are many more questions, but I am trespassing on your good nature at this point, and I am sure we will have other opportunities to discuss this.

Thank you very much, Mr. Chairman.

Senator LUGAR. Secretary Hormats, Secretary Leland, we very much appreciate your coming here today, and the cooperation of the Departments of State and Treasury in making this hearing a meaningful one. We look forward to further consultation with you.

Mr. HORMATS. Thank you. I have no doubt that we will be back.

[Pause.]

Senator LUGAR. At this point, the Chair will call to the witness table our panel of public witnesses, consisting of the Honorable Richard Davies, former U.S. Ambassador to Poland, Lawrence J. Brainard, an international economist for Bankers Trust Co. of New York, and

Prof. Stanislaw Wasowski, professor of international economics at Georgetown University.

Gentlemen, would you please come to the witness table?

[Pause.]

Senator LUGAR. Gentlemen, we welcome you to this hearing. We appreciate your patience and understanding. Without further introduction, I would like to ask you to proceed in this order. First Mr. Brainard, then Ambassador Davies, and Professor Wasowski. If you will make your presentations in order, then we will engage in a question and answer dialog.

TESTIMONY OF LAWRENCE J. BRAINARD, INTERNATIONAL ECONOMIST FOR BANKERS TRUST CO., NEW YORK, N.Y.

Mr. BRAINARD. Thank you very much, Mr. Chairman.

Mr. Chairman, Senator Biden, I have prepared a written testimony for the record, and I would like to summarize its key points, so that we can address some of the issues in the question and answer session.

I address two major issues. Looking at the history of the past 10 years in Poland, there is first of all the question of the factors that explain the inability of the Polish authorities to make necessary economic policy changes so as to contain the growing economic crisis. Second, and the issue to which I will address most of my attention, is to explain the apparent breakdown of disciplines in international lending which allowed Poland to amass over $25 billion in debts.

In looking at developments in Poland there are really two periods, a period up until about 1975–76, and the period from 1975–76 until 1980, when the economy went into deep crisis. The point I make with regard to the first item—the inability of the Polish Government to deal with its economic problems—is that one must look at the political context in Poland and the fact that the economic policy of the regime was an economic policy that was irrational.

On the other side of that issue, one has to agree that Mr. Gierek was an extremely popular leader in the West. While the banks were encouraged to lend money to Poland in order to support exports and the development of natural resources, the influence of the Western governments on their activities was very strong. In the eyes of most Western governments, Gierek represented the best that détente could offer. He was a flexible Communist leader with big orders for exporting firms. He was, without question, the most popular Eastern European leader in the West during the seventies.

If we look at the period 1976 to 1980, this is a period during which it was possible to identify the serious economic problems. In 1976 the Government attempted to increase meat prices. This led to riots. The Government reacted by trying to come to grips with the economy's problems. This encouraged all kinds of ad hoc administrative measures and direct controls, particularly on imports.

Now, I must explain a most important fact, that from 1976 until 1980, Poland's foreign debt rose from $11.5 billion to $24 billion. How could this have taken place? First of all, we have to understand the composition of debt. As an example, let's look at the latest figures

which refer to 1981. On January 9, the Polish Government announced that the total foreign debt of Poland was $28.5 billion at the end of 1981. Of this sum, $7.5 billion or about 25 percent is owed to commercial banks in Western Europe, the United States, Canada, and Japan.

An additional $11 billion is owed to governments in these areas, for example, Western Europe, the United States, Japan, and Canada. Eleven billion dollars represents about 39 percent of the total debt. Approximately 70 percent of both sums are due to West European banks and governments. In other words, over 70 percent of all of this debt is owed to banks and governments in Western Europe. The remaining $10 billion to get up to the total $28.5 billion debt is owed to governments and banks outside the Western industrial countries and to nonbank corporate creditors. Unfortunately, we do not have a full breakdown of these sums, but these would include developing countries, Middle Eastern countries, and, of course, socialist countries.

When Poland's economic problems became evident, bank reactions varied. U.S. banks, for example, restricted their lending beginning in 1976. Between the end of 1976 and June 1978, total loans from U.S. banks rose only $35 million, at a time when all bank loans rose over $5 billion. By restricting new loans, U.S. banks hoped to bring indirect pressure on the Polish Government to change policy. Since there was a hope that such a change in policy was possible, U.S. banks were willing to take a wait and see attitude, rather than pull out the rug, which would have made economic adjustment very difficult.

The attitude of U.S. banks was a source of concern in Warsaw at this time, but governments and banks in Japan and Western Europe were persuaded to increase their loans to fill the void created with the withdrawal of the U.S. banks. We do not know the full story of Poland's borrowing strategy during this period. What I would emphasize is the important role that Western governments played in increasing lending in this critical period.

The Gierek government was largely successful in leveraging its political ties with the United States and Western Europe to secure additional credits. The Carter administration, for example, substantially increased financing for Polish grain purchases under CCC [Commodity Credit Corporation] arrangements with no conditions attached. Some West European governments at this time were breaking the informal rules on official credits. Although these credits are supposed to be tied to capital goods or spare parts, in fact, they were increasingly used for medium term financing of raw materials and semifabricated goods.

With all of this financing going on, it is not surprising that the restraint shown by U.S. banks had little effect on Polish economic policies. I believe the evidence shows that U.S. banks acted responsibly at this period of time. They continued to maintain the level of exposure, and led an effort which succeeded in obtaining economic data on Poland's balance of payments and foreign debt. But given the lack of unity among lenders, and given the policies of the West European governments, the U.S. banks were not in a position to influence economic policy in a more direct fashion, and no effort was made to do this.

Let me draw the conclusions then for your consideration regarding future U.S. policy. Since other members of the panel will address political issues, I will restrict my comments to economic matters.

The record of the past 10 years suggests two major conclusions. One is that Gierek's populist policies led to a weakening of internal disciplines and an erosion of the Government's ability to manage economic activity. The restoration of these disciplines is not a matter of finding a new mix of economic policies. It is, rather, a fundamental issue of economic structure, structure defined as the framework in which economic activity is carried out, the way in which factories, managers, workers, and farmers interact, and structure which provides the stability necessary for steering the economy.

Poland's economy today is without such a structure. The role of money, for example, has been seriously undermined by excessive monetary creation and fixed prices in retail stores. Such a situation has fueled a flight from money, a rampant black market, and regression into barter. Economic management is described by a continuing series of ad hoc directives.

The Government is now preparing a new package of economic laws, but it remains to be seen how effective these laws will be.

A second conclusion is that Poland's access to external credit has never been subject to conditions that would insure a rational and efficient use of these funds. Any agreement by the U.S. Government to reschedule Polish debts or to extend new credits should be based on explicit conditionality regarding Polish economic policies. We are talking about a point in time when martial law is ended and the U.S. Government is looking at this possibility.

The record shows that Western governments, in particular those in Western Europe, bear a major share of the responsibility for the uncontrolled expansion of Polish indebtedness in the period after 1975. Loans were offered in the name of Ostpolitik or export promotion with little or no consideration of Poland's ability to use these funds. When problems became serious in the late seventies, some of the governments made special deals or bent the rules governing export credits. The Carter administration bears a portion of this blame for its decisions made purely on political grounds to authorize substantial increases in CCC credits to Poland.

The differing policies of United States and European banks have already been mentioned.

I would like to explain why banks are not in a position to enforce the kind of conditionality that the governments avoided insisting upon. The basic reason is that banks find it very difficult to work together as a group. There are over 500 banks, both large and small, from many different countries, who hold claims on Poland. It is unlikely that any of these banks agree on all matters of economic policy or, for that matter, have the necessary background to make recommendations on macroeconomic policy.

Banks can have a strong indirect influence on policy by restricting new loans, but we are much beyond that situation today. The banks must look to governments or the IMF [International Monetary Fund] to enforce conditionality.

Western governments are still avoiding the issue of conditionality. Mr. Hormats commented that the government has not worked out any kind of conditionality if martial law were, in fact, to be ended. To be sure, the governments are uneasy about making recommendations, given their concerns about Soviet policies, given their concerns about imposing themselves in another sovereign nation, but the issue remains and cannot be avoided even now that we have the prospect of IMF membership for Poland later this year. In any case, the IMF will not be eager to accept the responsibility that its member governments are trying to avoid.

My recommendation is that any future decision by the United States to reschedule Polish debt or to provide new credits be based on explicit and detailed economic conditionality. The U.S. Government has the necessary resources to define and articulate which conditions are appropriate in Poland's case. Hopefully, the IMF will also be able in time to assist in this task.

Thank you.

[Mr. Brainard's prepared statement follows:]

PREPARED STATEMENT OF LAWRENCE J. BRAINARD

During the seventies Poland and many other countries faced serious balance of payments problems. Despite sharp hikes in oil prices and slow economic growth in industrial countries, most countries were able to make needed economic adjustments: these countries continue to meet their external obligations. Poland was an exception. In March 1981 Polish authorities acknowledged their inability to meet principal and interest payments and requested creditors to reschedule the country's debts.

In seeking to assess the reasons for Poland's debt problems, two issues are of foremost concern. The first is to identify the factors which explain the inability of Polish authorities to make necessary economic policy changes so as to contain the crisis. The second is to explain the apparent breakdown of disciplines in international lending which allowed Poland to amass over $25 billion in debts.

FAILURES OF ECONOMIC MANAGEMENT 1970–75

The roots of Poland's debt crisis go back to the 1970 riots which led to the appointment of Edward Gierek as first secretary of the Polish United Workers Party. Workers' discontent brought Gierek to power; his new policies reflected an attempt to placate them and other important social groups in Polish society. This was populism pure and simple, a strategy to gain political support by giving everyone what he wanted: higher wages for workers, higher prices for farmers, Western technology for industry, and economic reform to top it off.

Foreign trade was given a critical role to play in Gierek's new economic strategies. In the traditional centrally planned economy, policy makers act to balance imports and exports by virtue of their wide-ranging control over resource allocation. Imports, thus, are effectively restricted by the country's ability to export. The new strategy turned this approach to balance of payments management on its head. It was argued that traditional central planning was responsible for the stagnation in which the economy found itself in the late sixties. Further, what was needed was an infusion of western technology to be financed by Western credits. Such credits could be repaid out of the exports to be generated by the new investments.

In view of Poland's resource endowment (coal, sulfur, copper), such a strategy seemed feasible in the abstract. In reality, the strategy's implementation contributed to the rapid escalation of serious economic disequilibria. Imports were now limited only by the possibilities of obtaining credits in the West. The traditional discipline that imports should balance exports was removed, but an effective system to set import priorities and to ensure that such imports generated exports was not implemented. The new approach actually weakened the central

control of the planning commission by decentralizing decision making to the industrial ministries and large industrial conglomerates. But the rest of the centrally planned model remained intact, replete with irrational prices and other familiar inefficiencies. In a word, the new model retained all the irrationalities of the old system, but without the benefits of its controls on foreign trade and investment.

Given an unrestrained demand for credit, the only effective limitation on borrowing came from the lenders. Such restraints were not binding, either from the banks or Western governments. Most banks were inclined toward an optimistic assessment of Poland's economic prospects. After all, Poland's level of debt was very low, the economy was endowed with many natural resources, it was a net energy exporter and credits went for purchases of investment goods. There was also a general assumption in the market that planned economies could easily control imports if necessary and that the Soviet Union would stand behind borrowings by any Eastern European country.

One American bank, however, took a different approach. In 1975 the Chase Manhattan Bank persuaded the Polish Government to organize a credit for the development of a copper mine and smelter. The agreement provided extensive data and annual on-site reviews of the project to the lenders. Although loans to Poland and other Eastern European countries conformed to Eurocurrency market practice as regards term, rate and legal agreements, none of these countries provided basic information on balance of payments, reserves and foreign debt as did most developing country borrowers. Chase was concerned that the rapid expansion of credits could prove unsound, because the banks had no way to ensure that the funds were used effectively. Although the Chase credit was a success, particularly with other American banks, it did not set a pattern in the market. In retrospect, of course, Chase was right, but the market did not fully support this initiative.

Western governments were just as eager to provide credit at this time as the banks. In the eyes of most Western governments, Gierek represented the best that détente could offer, a "flexible" Communist leader with big orders for exporting firms. He was without question the most popular Eastern European leader in the West during the seventies. Western government attitudes toward Poland, in turn, were a significant factor that encouraged banks in their lending. Summing up, the root causes of Poland's economic crisis may be identified as the politically popular but economically irrational policies of the Gierek leadership. The implementation of these policies removed critical internal economic disciplines. The lack of effective constraints on Polish economic performance from the side of most bank and Western government creditors permitted economic disequilibria to worsen. By 1975 the current account deficit exceeded $3 billion, up from near balance in 1972.

THE WORSENING ECONOMIC CRISIS 1976–80

In June 1976, the Polish Government introduced substantial increases in meat prices, seeking to reduce the growing burden of subsidies on the budget resulting from the fixed price policy in place since 1971. After a series of riots broke out in several industrial cities, the government rescinded the measures. Industrial workers were the major beneficiaries of Gierek's populist policies. Because of the failure of the attempt to increase meat prices, the government feared imposing the costs of adjustment on the workers. This fear reflected the fact that Gierek's political support rested on his ability to keep workers happy with continuing rises in real incomes. The policy imperatives, therefore, were to tinker with economic reform in the hopes that productivity could be increased, to squeeze a little out of agriculture and to placate Poland's creditors in the West.

The government's attempts to come to grips with the economy's problems encouraged all kinds of *ad hoc* administrative measures and direct controls, particularly on imports. Cuts in imports, however, interfered with the completion of many half-finished projects and prevented the growth in exports which were needed to reduce the current account deficits. Sustained large current account deficits, in turn, forced the government to find new loans in the West.

Between 1976 and 1980, Poland's foreign debt more than doubled, rising from $11.5 billion to $24.0 billion. In order to understand how such an increase was possible, we must first look at the current composition of debt. Polish authorities announced on January 9 that the total debt was $28.5 billion at the end of 1981.

Of this sum, $7.5 billion, or about 25 percent, is owed to 501 commercial banks in western Europe, Japan, Canada and the United States; another $11 billion (39 percent) is owed to these governments. Approximately 40 percent of these sums are due to West European banks and governments. The remaining $10 billion is owed to governments and banks outside the Western industrial countries and to non-bank corporate creditors. A breakdown of these sums is not available.

These data on commercial bank exposure are substantially lower than the $16.2 billion figure published by the Bank for International Settlements. The BIS data pick up an unknown portion of bank loans which have Western government guarantees and substantial amounts of claims registered by banks located in Western Europe but owned by governments elsewhere, e.g., Arab countries, Eastern Europe, and developing countries.

Bank reactions to the worsening economic situation varied. U.S. banks, for example, restricted their lending to Poland. Between December 1976 and June 1978, claims of U.S. banks rose only $35 million, while total bank claims were rising over $5 billion. By restricting new loans, U.S. banks hoped to bring indirect pressure on the Polish Government to change policy. And since there was a hope that such change was possible, the U.S. banks were willing to take a wait and see attitude rather than "pull out" loans which would have made economic adjustment much more difficult.

Although the attitude of U.S. banks was a source of concern in Warsaw, governments and banks in Japan and Western Europe were pursuaded to increase loans to fill the void created by the withdrawal of U.S. banks. The full story of Poland's borrowing strategies during this period are not fully known. Two factors probably account for much of the increased lending by banks. One was the aggressive move beginning in 1977 by many European and Japanese banks into all types of international lending. These banks were less insistent than American banks on economic disclosure and they were more inclined to look for comfort at non-economic factors such as an assumed Soviet commitment to support borrowings by Eastern European countries (the umbrella theory).

These banks were also more susceptible to efforts by Poland's Bank Handlowy to "piggy back" its credit requirements on imports other than capital goods. Imports of raw materials, spare parts and the like, which had been settled in cash or short-term credit were now being financed by 2- and 3-year credits. The Polish importer would tell the exporter that he must arrange credit in order to get the contract. The company would then turn to its house bank for financing. The data appears to indicate that many of these banks were reluctant to refuse such questionable financing requests. These practices substantially shortened Poland's debt maturity profile, causing a rapid escalation in the country's debt service requirements and aggravating the country's economic difficulties.

The Gierek government, meanwhile, was largely successful in leveraging its political ties with the United States and Western Europe to secure additional credits. The Carter administration, for example, substantially increased financing for Polish grain purchases under CCC arrangements; this resulted in a sharp jump in official U.S. claims on Poland. Some Western European governments at this time were bending the informal rules on official credits. Although these credits are supposed to be tied to capital goods or spare parts, they were increasingly used for medium-term financing or raw materials and semi-fabricated goods. Substantial amounts of credit were also raised by Poland from new government sources in the Middle East and Latin America.

With all of this financing going on, it is not surprising that the restraint shown by U.S. banks had little effect on Polish economic policies. I believe the evidence shows that U.S. banks acted responsibly at this time. They continued to maintain their level of exposure and led an effort which succeeded in obtaining economic data on Poland's balance of payments and debt. Given the lack of unity among lenders, the U.S. banks were not in a position to influence economic policy in a direct fashion and no effort of this nature was made.

Events in 1979–80 followed a predictable course. As financing requirements mounted, the government belatedly began to move in earnest to shore up the economy. The 1979 austerity plan tightened the screws on the economy with sharp investment cuts and tight controls on imports. Yet real wages were slated to grow 1.5–2.0 percent in the plan, reflecting the government's reluctance to put any of the adjustment burden on workers.

As the years wore on and as few signs of progress were evident, the Polish authorities approached the French and German Governments with a request to

refinance maturing export credits. Breaking longstanding agreements with other Western governments, the French agreed to a bilateral rescheduling of FF1,250 million or about $300 million. The German Government refused a rescheduling but offered modest amounts of new credit. These funds enabled Poland to meet its financing requirement into early 1980, but time was running out. By mid-1980 the economy had plunged into deep crisis.

CONCLUSIONS

Future U.S. policy toward Poland must be based on a consideration of both political and economic factors. Since other members of the panel will address political issues, I will restrict my comments to economic matters.

The record of the past ten years suggests two major conclusions. One is that Gierek's populist policies led to a weakening of internal economic disciplines and an erosion of the government's ability to manage economic activity. The restoration of these disciplines is not a matter of finding a new mix of economic policies; it is, rather, a fundamental issue of economic structure. The structure of an economy defines the framework in which economic activity is carried out, the way in which factories, managers, workers, farmers, etc. interact and it provides a stability necessary for steering the economy.

Poland's economy today is without such a structure. The role of money in the economy, for example, has been seriously undermined by excessive monetary creation and fixed prices in state retail stores. Such a situation has fueled a flight from money, a rampant black market and a regression into barter. Economic management is described by a continuing series of *ad hoc* directives; an annual plan for 1982 was not even drawn up. The government is preparing a new package of economic laws in an effort to improve the functioning of the economy. It remains to be seen how effective these laws will be in providing the needed definition of a workable economic system of planning and management.

A second conclusion is that Poland's access to external credit has never been subject to conditions that would ensure a rational and efficient use of these funds. Any agreement by the U.S. Government to reschedule Polish debts or to extend new credits should be based on explicit conditionality regarding Polish economic policies.

The record shows that Western governments, in particular those in Western Europe, bear a major share of the responsibility for the uncontrolled expansion of Polish indebtedness in the period after 1975. Loans were offered in the name of Ostpolitik or export promotion with little or no consideration of Poland's ability to use these funds. When problems became serious in the late seventies, some of the governments made special deals or bent the rules governing export credits. The Carter administration bears a portion of this blame for its decisions made purely on political grounds to authorize substantial increases in CCC credits to Poland. There are still many unanswered questions regarding lending policies of Western governments during this period which deserve further study.

The differing policies of United States and European banks during this period has already been covered in detail above. What remains is to explain why banks cannot enforce that kind of conditionality that governments avoided insisting upon. The basic reason is that banks find it very difficult to work together as a group. Over 500 banks, both large and small from many countries, hold claims on Poland. It is unlikely that all of these banks agree on economic policy issues or for that matter have the necessary background to make recommendations on macroeconomic policy. Banks can have a strong indirect influence on policy via restrictions on new loans. But in situations such as this one, they must look to governments or the IMF to enforce conditionality.

Western governments are still avoiding the issue of conditionality. The rescheduling of government credits signed in April 1981 contained no effective economic conditions. To be sure, the governments were uneasy about making such recommendations given their concern about Soviet policies. The issue, however, remains and cannot be avoided even now, given the prospect of IMF membership for Poland later this year. In any case, the IMF will not be eager to accept the responsibility that its member governments may wish to thrust upon it.

My recommendation is that any future decision by the United States to reschedule Polish debt or to provide new credits be based on explicit and detailed economic conditionality. The U.S. Government has the necessary resources to define and articulate which conditions are appropriate in Poland's case. Hopefully, the IMF will also be able, in time, to assist in this task.

COMMERICAL BANK CLAIMS

[Dollar amounts in millions]

	Of which:		
	Total	U.S. banks	In percent of total
December 1976	$5,615	$1,207	21.5
December 1977	8,840	1,242	14.0
June 1978	10,726	1,242	11.6
December 1978	12,441	1,216	9.8
June 1979	13,528	1,361	10.1
December 1979	15,846	1,413	8.9
June 1980	15,752	1,421	9.0
December 1980	16,173	1,461	9.0
June 1981	NA	1,274	

Source: Bank for International Settlements, Federal Reserve System.

Senator LUGAR. Thank you very much, Mr. Brainard.
Ambassador Davies.
[Ambassador Davies' biographical data follows:]

BIOGRAPHICAL DATA OF RICHARD T. DAVIES

A Foreign Service Officer of the rank of Career Minister, Davies retired on February 29, 1980, after 36 years of government service. He spent nearly 33 years in the Foreign Service, more than 25 of them in assignments involving United States relations with the Soviet Union and Eastern Europe. Fourteen of those 25 were spent in assignments involving Eastern Europe, with particular emphasis on Poland. During their two assignments there, Ambassador and Mrs. Davies lived in Warsaw for more than 7 years.

Born in Brooklyn, New York, on May 28, 1920, Davies obtained the A. B. degree from Columbia College in New York City. He served in the Army in World War II and was a member of civil-affairs and military-government teams in Belgium, the Netherlands, and Germany. After the War, he taught German at Brooklyn Polytechnic Institute before entering the Foreign Service in 1947.

Davies' first Foreign Service assignment was to the American Embassy in Warsaw, where he saw the beginning of the reconstruction of war-ravaged Poland and the simultaneous imposition of Communism on the strongly anti-Communist and anti-Russian Polish people. He described aspects of this period in Polish history in "The Fate of Polish Socialism," published in Foreign Affairs in October, 1949 (and republished in Philip E. Mosely (editor), "The Soviet Union, 1922–1962—A Foreign Affairs Reader," Frederick E. Praeger, New York-London, 1963), and a chapter which will appear in a book edited by Professor Thomas T. Hammond under the title "Witnesses to the Origin of the Cold War," to be published shortly by the University of Washington Press.

Following Russian language-and-area training, Davies was assigned to Moscow and saw the end of the Stalin era and the beginning of the "thaw." He served subsequently at the headquarters of the North Atlantic Treaty Organization, then located at Paris, and at the American Embassy in Kabul, Afghanistan. Davies was then assigned to work in the Department of State, which included participation in the 1959 visit of Vice President Nixon to the Soviet Union and Poland and in the subsequent visit of Nikita S. Khrushchev to the United States.

Davies was Counselor for Political Affairs in the American Embassy in Moscow during the Cuban missile crisis of October, 1962, and, under the direction of Ambassador Foy D. Kohler, was responsible for working contacts with the Soviet Ministry of Foreign Affairs during the ten days of the crisis.

On loan to the United States Information Agency from 1965 to 1968, Davies directed that Agency's extensive program in the Soviet Union and Eastern Europe. He traveled widely in the area and defended before the competent Congressional committees the portion of the USIA budget allocated to activities in the U.S.S.R. and the countries of Eastern Europe. During this assignment, he wrote "The American Commitment to Public Propaganda," which appeared in Clark C. Havighurst (editor), "International Control of Propaganda," Oceana Publications, Dobbs Ferry, New York, 1967. In 1968, he received the USIA Superior Honor Award.

During his five years as ambassador in Poland, Davies was involved in planning the visits of Presidents Ford and Carter to Poland and of First Secretary Edward Gierek to the United States. U.S. trade with Poland quintupled during this period, from a turnover of approximately $200-million in 1970 to over a billion dollars in 1976.

Davies summarized his views on events in Poland during his tenure as ambassador there in an essay, "Politico-Economic Dynamics of Eastern Europe: The Polish Case," which appeared in "East European Economic Assessment: A Compendium of Papers Submitted to the Joint Economic Committee of the Congress of the United States" (Washington, D.C., February 27, 1981).

Since he retired from the Foreign Service, articles by Davies have been published in The Washington Post, The Washington Star, The Christian Science Monitor, and The Los Angeles Times. He has lectured widely and appeared on many national and local television and radio programs.

Davies speaks Polish, Russian, French, and German. He is married to the former Jean Stevens. The Davieses have four sons.

A summary of Davies' career follows.

February 29, 1980—Retired from the Foreign Service.

1979–80—Director, HUMINT Tasking Office, Collection Tasking Staff (Intelligence Community Staff), Washington.

1978–79—Guest Scholar, Kennan Institute for Advanced Russian Studies, The Woodrow Wilson International Center for Scholars, Washington.

1973–78—U.S. Ambassador to Poland.

September 22, 1974—Appointed Foreign Service Officer of the Class of Career Minister.

1970–72—Deputy Assistant Secretary of State for European Affairs, Department of State, Washington.

1969–70—Senior Coordinator, Planning and Coordination Staff, Department of State, Washington.

1968–69—U.S. Consul General, Calcutta, India.

1965–68—Assistant Director (Soviet Union and Eastern Europe), United States Information Agency, Washington.

1964—Deputy Executive Secretary, Department of State, Washington.

1963–64—Member, Sixth Senior Seminar in Foreign Policy, Foreign Service Institute, Washington.

1962–63—Political Counselor, American Embassy, Moscow, U.S.S.R.

1961–62—Political Officer, American Embassy, Moscow, U.S.S.R.

1959–61—Public Affairs Adviser, Office of Soviet Union Affairs, Department of State, Washington.

1958–59—Public Affairs Adviser, Office of Eastern European Affairs, Department of State.

1955–58—Political Officer, American Embassy, Kabul, Afghanistan.

1953–55—Political Officer, International Staff, North Atlantic Treaty Organization, Paris.

1951–53—Political Officer, American Embassy, Moscow, U.S.S.R.

1950–51—Russian language-and-area studies, Foreign Service Institute, Washington; Middlebury (Vermont) College; Russian Institute, Columbia University, New York, N.Y.

1947–49—Consular Officer and Political Officer, American Embassy, Warsaw.

STATEMENT OF HON. RICHARD T. DAVIES, FORMER U.S. AMBASSADOR TO POLAND, CHEVY CHASE, MD.

Ambassador DAVIES. Mr. Chairman, Senator Biden, I am delighted that you are holding this hearing. My only regret is that you waited so long. It would have been good to hold this hearing 15 months ago or at least a year ago when something might have been done, in my opinion, to avoid the present unhappy outcome in Poland.

I have prepared a rather lengthy written statement which I would like to submit for the record. And I will just summarize that, if that is acceptable.

Mr. Chairman, in true diplomacy both sides receive something of equal value and each delivers what it has promised, because to do other-

wise would open it to losses it would rather avoid. When one side pays in advance and the other does not deliver the quid pro quo it has contracted to but does not suffer a penalty commensurate with the gravity of that breach of contract, we are talking not about diplomacy but, at best, about a giveaway and, at worst, about appeasement.

In plain American, that kind of "bargain" means that one side has been played for a sucker. Such has been the bargain of the seventies, or détente. This European-devised policy was based on the assumption that development of trade between East and West would be accompanied by a gradual liberalization of Soviet totalitarianism and some loosening of Soviet domination over the people of Eastern Europe.

Accordingly, the West has engaged over the past 10 years in rapidly growing trade with the U.S.S.R. and Eastern Europe, trade financed on medium- and long-term credit. Today, as we all know, the Soviet bloc's hard currency debt is about $80 billion, or roughly the equivalent of 1 year's overt Soviet military budget.

Whether we intended it or not, those credits permitted the Soviets to pursue simultaneously two important policy objectives: Their enormous arms buildup of the seventies, for which we are now going to be asked to pay during the eighties and the provision of gradual if only very slight increases in the standard of living of the peoples of their bloc, beginning with the Soviet people themselves.

In short, those massive Western credits enabled the Soviets to have both guns and butter. The primary significance for the West of the crushing of the peaceful Polish experiment in economic, social, and political self-determination is the graphic demonstration it provides of the fallaciousness of the Western assumption that détente would lead automatically to liberalization within the Soviet empire, that all we had to do was get the signature of the Soviet leaders to a few documents, like the Basic Principles of United States-Soviet Relations, signed by Nixon and Brezhnev at the Moscow summit in May 1972, or Basket Three of the Helsinki Final Act of July 1975, in order to insure such a liberalization.

The dean of British Sovietologists, Prof. Leonard Schapiro, wrote as follows:

> "Have the suffering and the courage of the Polish workers which have aroused worldwide sympathy and admiration been in vain? Not if the main lesson has been learned by the Western powers. This lesson is that action in defense of freedom in the world must be directed at the real enemy of that freedom—the Soviet Union. Not military action, of course—no one but a lunatic would advocate that—but economic action which exploits the greatly superior material wealth of the combined countries of the Western world and denies to the Soviet Union the means to develop its military power with Western aid which it at present enjoys. We are a long way," wrote Professor Schapiro, "from the kind of agreement all the Western powers which is required before such a policy can be fully implemented. President Reagan," he wrote, referring to the sanctions, "has taken the first step. But if we are not to stagger from one defeat by the Soviet Union to the next, we have no time to lose in trying to secure the kind of coordination of aims that will ultimately make a joint economic policy of the Western world toward the Soviet Union possible."

Western economic policy—or I should say the absence of Western economic policy—toward Poland is also exemplary. Before August 1980, the United States was providing assistance to the Polish Communist leadership, primarily in the form of Commodity Credit Corporation credit guarantees for the purchase of feedgrains. Despite

growing evidence of the financial and economic irresponsibility of the Polish regime, we made it the largest beneficiary in the world of the limited amounts of those guarantees.

The rise of the independent self-governing workers and farmers Solidarity Unions made no difference in our pursuit of this policy of assisting the Communist regime. Since August 1980, the West, as a whole, has provided over $4.6 billion in new credits and the proceeds of the rescheduling of payments due to the Polish Communist Government, "with the understanding that it would promote this ongoing process of liberalization," as Under Secretary of State for Political Affairs Stoessel put it on December 27.

But that "process of liberalization" in Poland went on only until December 13 and resulted not in economic or other reforms but in martial law. Foodstuffs which the Polish Communists were enabled to acquire or stockpile only thanks to those credits and Western food aid were hidden in the barracks of the secret police and suddenly delivered to the shops on December 14, the day after the proclamation of martial law.

So the West, including the United States, helped the Polish Communists "resist the imperatives of commitment to reform" by providing them with economic assistance before they had demonstrated such a commitment.

In response to the imposition of martial law in Poland, the only effective Western sanctions would be the cancellation of the Yamal pipeline deal by the West Europeans and a U.S. embargo on shipments of grain to all the Warsaw Pact countries and of phosphates to the U.S.S.R.

But from the beginning of martial law on December 13, administration spokesmen had said that a new grain embargo would be considered only if the Soviet army invaded Poland, and West European leaders had been saying that suspension of the Yamal pipeline deal could be considered only if the Soviet army invaded Poland and if the United States imposed a grain embargo.

We delude ourselves; we are naive if we think the sanctions that have been imposed show that we are not doing business as usual with the Soviet Union. Recognizing that the administration would not invoke a grain embargo since that would hurt a sizable group of its constituents who wield a significant number of electoral votes, some critics of the feebleness of Western and particularly U.S. reaction to the imposition of martial law have stopped talking about it, seeking another possible action which the administration could take in the effort to appear tough.

These critics have come up with the proposal that a formal default be precipitated upon Poland's hard currency debt. They contend that this would put a stop to the further expansion of Western credits to the Soviet Union and Warsaw Pact countries and hence to East-West trade.

Well, I am no expert on international finance. You heard just before us two such experts. And Larry Brainard here is an expert, and Professor Wasowski is an expert. I seriously doubt the ability of the U.S. Government to precipitate a default, particularly since it joined with 14 other creditor governments last April in an unconditional 4-year rescheduling of the $2.6 billion in payments due in 1981 from

Poland. As Larry Brainard has pointed out, is Poland now in default to the U.S. Government? If not, when may it next be in default? Would American banks follow the Government lead in proclaiming a default?

West European governments and banks, which hold a much larger share of the Polish debt, certainly would resist a unilateral U.S. declaration of default, even if one were possible. And what effect would such a unilateral U.S. action have on the already fragile condition of NATO?

So what should we do about the Polish debt? For one thing, we should strive to assure that the current martial law regime does not contract new hard currency debts. I heard Messrs. Hormats and Leland assure us that they would not be able to contract new hard currency debts. I wish I could be sure that would be the case.

If it were technically possible to use the threat of default, I would favor the U.S. Government's finally moving to resume our leadership of the West and fashioning a united Western policy requiring that the Polish Communist authorities lift martial law immediately, release all political prisoners and detainees, rovoke all of the illegal decrees promulgated since December 13, and resume negotiations with the presidium of Solidarity and its advisers.

If they were to do this, the West should declare its willingness to grant a moratorium on payments due for a reasonable period, say, 3 months, and when agreement had been reached between Solidarity and the Polish authorities, the West should be prepared to act urgently and sympathetically on Poland's application for IMF membership and to establish a schedule of balance-of-payments credits to Poland in installments keyed to the implementation of the provisions of the new social contract.

Eventually, Mr. Chairman, the Polish Communist leaders will have to conclude that they cannot turn the clock back to Stalinism. The Polish people cannot be made to work productively at the point of a gun or in the shadow of a tank.

Under these circumstances, the West should consistently offer a reasonable way out and should do what it can to insure that the choice is placed squarely before the Polish leaders in the sight of the Polish nation and the world. Those leaders must be forced to choose either to continue following the path of the confederates of Targowica, who, in 1972, conspired with the Empress Catherine of Russia to betray Poland or to try yet again to find the "Polish way to socialism."

As Professor Schapiro said, the present sacrifices of the Polish nation and its 35-year struggle "that Poland might be Poland" will not have been in vain if, from this tragic experience, the West learns that it must stop supporting the Soviet arms buildup and unlimited Soviet suzerainty over Poland and the other East European peoples.

Thank you.

[Ambassador Davies' prepared statement follows:]

PREPARED STATEMENT OF HON. RICHARD T. DAVIES

At the end of February 1980, I retired from the Foreign Service after nearly 33 years as a career officer. I served twice in Warsaw, from 1947 to 1949 and 1973 to 1978, living there for more than 7 years. I also served twice in the U.S. Embassy in Moscow, from 1951 to 1953 and 1961 to 1963. In all, I spent 25 years in

assignments in the field and in Washington involving U.S. relations with the Soviet Union and the countries of Eastern Europe. Among these were 2 years as Deputy Assistant Secretary of State for European Affairs and 3 years as Assistant Director (Soviet Union and Eastern Europe) of the United States Information Agency.

In true diplomacy, as in any honest business transaction, both sides receive something of roughly equal value and each delivers what it has promised, because to do otherwise would open it to losses it would rather avoid.

When one side pays in advance and the other does not deliver the quid quo which it has contracted to, but does not suffer a penalty commensurate with the gravity of the breach of contract, we are talking not about diplomacy, but, at best, about a giveaway and, at worst, about appeasement.

In plain American, that kind of "bargain" means that one side has been played for a sucker.

Such has been the "bargain of the 1970's," more commonly called détente. This European-devised policy, so enthusiastically embraced by President Nixon, was based upon the assumption that the development of trade between East and West would be accompanied by a gradual liberalization of Soviet totalitarianism and some loosening of Soviet domination over the people of Eastern Europe.

When a business deal turns sour, the wronged party usually has sense enough to stop doing business with his delinquent partner. If he does not stop, he is no longer just a sucker, but an idiot to boot. "Fool me once, shame on you. Fool me twice, shame on me!"

In the wake of the imposition of martial law in Poland, the West now confronts the question of whether it is ready to stop being played for a sucker.

We have already had a good deal of experience with this kind of event. Regrettably, that experience, combined with the feebleness of Western reaction to the effort to restore Stalinism in Poland, does not lead me to believe that we are likely to call a halt to the successful Soviet effort to play us for a sucker. We seem determined, rather, to press on regardless to the next, higher stage—that of simple idiocy.

The Czechoslovak and Polish "Pauses."—On August 20, 1968, the armies of the Soviet Union, Poland, Eastern Germany, and Hungary invaded Czechoslovakia and spoiled President Johnson's plan to cap his term in office at a summit conference with General Secretary Brezhnev. The invasion resulted in the postponement of ratification of the Nuclear Non-Proliferation Treaty and of the beginning of the Strategic Arms Limitation Treaty (SALT) negotiations.

There was a Czechoslovak "pause" in the process of détente. It lasted roughly 6 months, until, in February 1969, the incoming Nixon Administration sent the Non-Proliferation Treaty to the Senate for ratification. In November 1969, the SALT negotiations began, but the delay from February to November had been occasioned by the new Administration's efforts to work out a U.S. position, rather than reluctance to negotiate with the Soviets.

Before December 12, 1981, in discussing the probable consequences in the West of Communist destruction of the reform movement of the Polish people, I estimated that a possible Polish "pause" in détente would last no longer than the Czechoslovak one.

I was wrong. The Polish "pause" ended with the meeting yesterday, January 26, in Geneva between Secretary of State Haig and Foreign Minister Gromyko. It lasted only a little more than 6 weeks, by contrast with the 6 months of the Czechoslovak "pause."

As events like the Warsaw Pact invasion of Czechoslovakia, the Soviet invasion of Afghanistan, and the armed repression of the Polish people repeat themselves, we get used to them and find less and less reason to upset what has become the natural course of events: the accelerating process of appeasing the aggressor. It is this process which bears the seeds of nuclear war, not Western insistence that the Soviet Union honor its international obligations.

Whose Side Are We On?—The absence of substantive Western reaction to the suppression of efforts by the peoples of Eastern Europe to choose their own "roads to socialism" is not the only way in which these two crises resemble each other.

"At the end of July [1968]," writes Professor Jiri Valenta, "Secretary of State Rusk denied publicly and in a conversation with Soviet Ambassador Dobrynin that the United States had any intention of being involved in the Czechoslovak situation. In Rusk's words, the Johnson administration 'did not want to give

any impression that the United States was behind the events in Czechoslovakia or that the United States tried to encourage the anti-Sovietism in this country'" (Soviet Intervention in Czechoslovakia, 1968: Anatomy of a Decision, The Johns Hopkins University Press, Baltimore and London, 1979, pp. 131–2).

Similarly, in the immediate aftermath of the "Polish August" of 1980, Secretary of State Muskie advised President Lane Kirkland of the AFL–CIO not to help Solidarity, and informed Ambassador Dobrynin that he had done so.

An act of like effect occurred in April 1981, when President Reagan fulfilled his campaign promise to lift the partial embargo imposed by the Carter Administration on Soviet purchases of grain over and above the 8-million tons for which contracts had been signed before the Soviet Army began its invasion of Afghanistan in December 1979. Incidentally, one reason the Carter embargo was not more successful was precisely the fact that the shipment of those 8-million tons was permitted.

In fairness to President Carter, I must add that the Afghanistan "pause" in many areas of United States-Soviet relations lasted from December 1979, to the end of his Administration and that he forebade the sale of some 17-million tons of grain over and above the 8-million tons authorized in the 1975 United States-Soviet grain agreement. The contrast with the response so far to the current repression in Poland is striking.

The lifting of the Carter embargo last April was opposed by Secretary of State Haig as likely to convey an incorrect signal to Moscow. It did so, leading the Soviet leaders to believe that they need not worry about a strong United States reaction to the destruction of the Polish reform movement. But the usual White House sources explained that, since the Soviets had not invaded Poland at the end of March and beginning of April, there really was no reason to hold back any longer on honoring the President's promise to the grain farmers.

As I wrote at the time, "It might be possible to make such a judgment a year from now . . . It is not possible now" (The Washington Post, April 26, 1981, p. C4).

Now we see a steady stream of signals which can only be interpreted in Moscow as meaning, "Heed what I do, not what I say about Poland."

The Theater Nuclear Force (TNF) negotiations continue without regard to the imposition of martial law in Poland.

While Administration sources predicted that, at yesterday's Haig-Gromyko meeting, no date would be set for the beginning of new strategic arms reduction talks (START), they—or equally anonymous colleagues—also opined that these talks would begin later this year without regard to the situation in Poland. As former State Department Counsel Helmut Sonnenfeldt wrote recently, "Arms-control negotiations 'delinked' from the rest of American-Soviet relations are likely to prove abortive once again" (The New York Times, December 14, 1981, p. A27).

Worst of all, both President Reagan and Secretary Haig have spoken repeatedly since December 13 of the likelihood of a Reagan-Brezhnev summit meeting later this year.

In the light of these signs that the U.S. Government is prepared to conduct business as usual with the Kremlin overseers of those who are holding the Polish people in a national prison-house, what effect can the January 30 extravaganza, "Solidarity with Poland," be expected to have? Will it not be simply a hollow demonstration of sentimental hypocrisy?

Food for the Jailers.—From President Reagan's April decision flowed agreements to sell the Soviets up to 23-million tons of grain during the October 1, 1981-September 30, 1982 grain year.

In the fall of 1979, the Soviets were moving small units of troops into Afghanistan, the Carter Administration—belatedly and, as it turned out, futilely—was warning them not to intervene militarily in the civil war there, and the Soviets were concluding contracts as quickly as possible with the international grain-brokers for large quantities of American wheat, corn, soybeans, and other food and feed grains. Consequently, when their troops entered Afghanistan in great force in December, the Soviet leaders were assured of enough bread to feed them and enough fodder to produce the meat for their field rations.

In 1981, too, the Soviet Union's grain-buying strategists did an excellent job.

Throughout the year, the Reagan Administration warned the Soviet leaders not to invade Poland and admonished the Polish leaders not to use force to settle their domestic problems. The White House statement of March 26, which

"reflects the views of the President of the United States," said: "We would like to make clear to all concerned our view that any external intervention in Poland, or any measures aimed at suppressing the Polish people, would necessarily cause deep concern to all those interested in the peaceful development of Poland and could have a grave effect on the whole course of East-West relations" (Department of State Bulletin, vol. 81, No. 2050, May 1981, p. 41).

In the light of statements like that, it was incumbent upon Soviet grain-buyers to move quickly and purchase as much in the American market as they could, once the necessary government-to-government agreements had been reached.

By December 13, 1981, they had bought about 11-million tons.

As it turned out, however, they need not have hurried. For, even after the introduction on December 13 of "measures aimed at suppressing the Polish people," the "grave effect on the whole course of East-West relations" did not involve even the partial embargo on grain purchases which President Carter had imposed. So the Soviets can continue to purchase American grain up to the limit of 23-million tons. In view of this year's disastrous Soviet harvest, they may need more than that. Those 23-million tons will be only about one-third of the shortfall. But we can suppose that, if American stocks are adequate, Secretary Block would favor authorizing them to buy more.

What then can those words of the March 26 statement have meant?

Judging by what the U.S. Government has done since December 13, it would appear they meant that the U.S. Government would invoke sanctions involving everything except those things that would hurt a sizable group of constituents, wielding a significant number of electoral votes.

Consequently, from the beginning of the martial-law regime on December 13, Administration spokesmen have been saying that a new grain embargo would be considered only if the Soviet Army invaded Poland. On December 26, nearly 2 weeks after the imposition of martial law, Secretary Haig said he thought such an invasion "may even be more possible than before" its imposition (The Washington Post, December 27, 1981, p. A6).

Apparently, the Administration had not come to terms with the fact that, from the outset of the Polish crisis in August 1980, the Soviet demand was that the Polish Communists themselves must deal with the matter. Nor, despite its accurate perception that the imposition of martial law had been strongly urged by the Soviet leaders, had it yet recognized that the principal reason for that insistence was extreme Soviet aversion to military involvement in Poland—an involvement which would risk splitting the Polish armed forces and the remnants of the Polish Communist Party and uniting them with the rest of the nation in resistance to Soviet occupation.

Nevertheless, putting forward the contention that, after all, the Soviets still might invade served two purposes. First, it helped bridge to some extent the chasm which had opened up between the Federal German and the U.S. Governments. According to Chancellor Schmidt, Soviet invasion was the only event which would trigger meaningful West German sanctions, starting with consideration of cancellation of the Yamal natural gas pipeline deal. So, despite their rhetorically quite different positions, the American and West German Governments were able to find a common excuse for their failure to respond effectively to the "measures aimed at suppressing the Polish people," imposed on December 13. The inconsistency of contending, on the one hand, that the Soviets were responsible for the Polish repression and, on the other, that only Soviet military invasion could trigger effective sanctions against the U.S.S.R. does not appear to worry the leaders of either government.

Secondly, the Administration justifies its refusal to consider a grain embargo by contending that something must be held back in order that some kind of sanction may be available to respond to a possible Soviet invasion.

A number of strong critics of the weakness of the Administration's response to the crushing of the Polish self-determination movement soon dropped the demand for a grain embargo and shifted their attention to another one: Declare that Poland is in default on its massive hard-currency debt, now about $29-billion and still climbing. This, some contend, would put a stop to the future extension of Western credits to the Soviet Union and hence to all East-West trade.

More important than the disposition of the Polish debt is the question of future credits, not only for Poland, but for the U.S.S.R., as well, and the exertion of Western leverage in an effort to help the Polish people—not, I emphasize, the Polish Communist leadership—but the Polish people.

Western Credits Support the Soviet Arms Build-up.—Before we turn to that subject, however, we need to understand the function of the credits extended by the West to the Soviet bloc.

Over the past 10 years, the West's rapidly growing trade with the U.S.S.R. and the countries of Eastern Europe has been financed on medium- and long-term credit. Today, the bloc's hard-currency debt is about $80 billion, o. roughly the equivalent of 1 year's overt Soviet military budget.

Whether we intended it or not, those credits permitted the Soviets to pursue simultaneously two important policy objectives: The enormous arms build-up of the 1970's and the provision of gradual, if only very slight, increases in the standard of living for the peoples of their bloc, beginning with the Soviet people themselves.

In short, those massive Western credits enabled the Soviets to have both guns and butter.

Growing Soviet military power has been translated into a significant growth in the international political influence of the U.S.S.R. This has been evident in many places: Somalia, Ethiopia, Angola, Indo-China, Yemen, Afghanistan, and, finally, Poland.

In the first six cases, the proposition is self-evident.

In the case of Poland, it became evident over the past year-and-a-half first in the timorousness of the Western reaction to the rise of the self-determination movement of the Polish people and now in the even greater timorousness of the Western reaction to the destruction of that movement.

Meanwhile, the West's mechanisms for dealing with this problem have been used less and less. The North Atlantic Council, the Coordinating Committee for Multilateral Export Controls (COCOM), the vast network of committees designed to produce a unified policy—all these have fallen into bureaucratic routine, uninformed by any agreed analysis of the present or common vision of the future.

In an effort to camouflage the debacle of Western policy following the imposition of martial law in Poland, there is a good deal of scurrying about as the Allies try to convey the impression that, after all, they can concert an agreed policy response.

Handsome is as handsome does, however, and the shadow-play being staged by Western leaders and officials will convince no one unless convincing action is taken.

In response to the imposition of martial law in Poland, the only effective Western sanctions would be the cancellation of the Yamal pipeline deal by the West Europeans and a U.S. embargo on shipments of grain to all the Warsaw Pact countries and of phosphates to the U.S.S.R.

The most important step that needs to be taken to restore faith in the North Atlantic Alliance is a determination that the members of the Alliance will no longer continue to finance the acceleration of the Soviet arms build-up by providing further massive credits to the states of the Warsaw Pact and the initiation of a system to control all trade and financial transactions with the Soviet bloc.

The dean of British Sovietologists, Leonard Schapiro, recently wrote:

> Have the suffering and the courage of the Polish workers, which have aroused worldwide sympathy and admiration, been in vain? Not if the main lesson has been learned by the Western powers. This lesson is that action in defense of freedom in the world must be directed at the real enemy of that freedom—the Soviet Union. Not military action, of course—no one but a lunatic would advocate that. But economic action, which exploits the greatly superior material wealth of the combined countries of the Western world and denies to the Soviet Union the means to develop its military power with Western aid, which it at present enjoys. We are a long way from the kind of agreement between all the Western powers which is required before such a policy can be fully implemented. President Reagan has taken the first step. But if we are not to stagger from one defeat by the Soviet Union to the next, we have no time to lose in trying to secure the kind of coordination of aims that will ultimately make a joint economic policy of the Western world toward the Soviet Union possible.[1]

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[1] The New York Review of Books, February 4, 1982, p. 4.

So far, regrettably, there is no sign that the Reagan Administration is preparing to set in motion this vital process, directed towards formulating a joint Western economic policy towards the Soviet bloc.

One important step could, and should, be undertaken immediately. That is the coordination of Western policy on the use of the important lever of Polish hard-currency indebtedness.

Conditionality Is Indispensable.—When I completed my mission in Warsaw in early 1978, I sent a final message to the State Department, assessing the situation in Poland and trying to look into the future. In that message and in a series of earlier ones, I stressed the economic irresponsibility of the Gierek-Jaroszewicz regime and said that, before the U.S. Government extended major new lines of credit to Poland, we must have assurances that the Polish Communist leadership would begin to observe sound principles of fiscal and economic responsibility. I suggested that the best form such assurances could take—and perhaps the only one we could regard as acceptable—would be membership of the International Monetary Fund.

In the fall of 1979, I sent a memorandum along these lines to the official of the National Security Council staff responsible for following Soviet and East European affairs, protesting against the decision to grant substantial new Commodity Credit Corporation credit guarantees to Poland.

I reiterated this point of view in letters I wrote in August and September 1980, to Secretary of State Muskie, Secretary of Agriculture Bergland, and a number of Senators and Representatives with membership on committees dealing with foreign affairs and agriculture.

The point I tried to make on all these occasions is the one I stressed in an article which appeared in The Washington Post on September 16, 1980: "Unless the Polish leadership commits itself first to reform, further Western credits will only encourage it to resist the imperatives of commitment" (p. A17).

Nevertheless, during the 16 months following August 1980, the U.S. Government extended credits in one form and another of over $1-billion to the Polish regime. And those credits, like those which that regime simultaneously obtained in Western Europe, did indeed "encourage it to resist the imperatives of commitment" to reform.

In fact, foodstuffs which the Polish Communist regime was able to acquire or to stockpile only thanks to the credits and food aid it received from the West during this period were hidden in the barracks of the security services and suddenly delivered to the shops on December 14, 1981, immediately after the proclamation of martial law.

Appearing on the CBS program "Face the Nation" on December 27, the Under Secretary of State for Political Affairs, Walter J. Stoessel, Jr., spoke of providing U.S. aid to Poland during the 16 months of the Polish Renewal "with the understanding that it would promote that process [of liberalization and Renewal]. It did not seem possible or appropriate to attach stringent conditions to that kind of aid in this ongoing process of liberalization. Now, I should say that the most recent request for large-scale aid—for the $740-million for credits—which came to us in September, was held up by us considering the types of conditionality which we could apply to that. . . . Now, of course, privately, we were in touch with government and Party representatives, urging them toward economic reform, and there were good signs that the government and Solidarity were in touch about working out those reforms."

But those good signs turned out to be designedly deceptive parts of the scenario which eventuated on December 13, 1981, not in economic reforms, but in martial law. The result is that the West invested some $4.6-billion in new credits and the proceeds of the rescheduling of payments due on an understanding that these resources would promote reform—an understanding which turned out to be naive and mistaken.

It is also not clear why, if the U.S. Government was prepared to consider the application of conditionality to the further credits which the Polish Communists asked for in September 1981, it could not have done so in September 1980, or—since President Carter's approval of $670 million in CCC credit guarantees for Poland in September 1980, was clearly motivated by the quest for Polish-American votes during the presidential campaign—at least beginning with the entry into office of the new President in January 1981.

The bald fact is that, once again, the United States paid in advance and the partner did not deliver what we had understood he would.

In the immortal words of Phineas T. Barnum, "There's a sucker born every minute."

Should We Declare Poland Bankrupt?—In an eloquent article in The New York Times of January 11, 1982, the distinguished financier, Mr. Felix G. Rohatyn, writes, "Let Poland go bankrupt."

I heartly agree with Mr. Rohatyn's contention that "The West has been relieving the Soviet Union of its greatest shortage—capital—at the cost of making bad loans while pretending to oppose Communism. That is bad business, bad policy, bad morality."

The trouble lies in proceeding from this point to Mr. Rohatyn's conclusion: "We should put the economic burden of the satellite states squarely on the Soviet Union and point up the bankruptcy of the Communist system by declaring bankrupt one of its largest units."

Whom would we help and whom would we hurt if we precipitated a formal default?

As a non-expert, I am not at all sure in the first place that we can precipitate a default. The Subcommittee will want to answer these questions as it considers this problem.

1. Last April, together with 14 other creditor governments, the U.S. Government agreed to a 4-year rescheduling of the $2.6 billion in payments due from Poland in 1981. Like all our other beneficences toward the Polish Communist regime since August 31, 1980, this rescheduling took place unconditionally. Is the Polish Government now in default to the U.S. Government on current payments due? If not, when may it next be in default?

2. What would be the effect of our declaring a default on our future trade relationship with Poland. Would the declaration of default on payments due the United States simply excuse the Polish Government the face value of its official debt to us or would it put us in the position at some now unforeseeable future date of negotiating a settlement of the amount due at so many cents on the dollar? In either case, would this not be a boon to the Polish Communist authorities and their Soviet sponsors?

3. Would the American banks follow the lead of the U.S. Government? The West European governments almost surely will not. And if they do not, would the West European banks? What effect would a unilateral U.S. declaration of default have upon the already fragile condition of the North Atlantic Alliance? Do we still care?

Using the Polish Debt.—The answers to these questions are sufficiently unclear in my mind to lead me to suggest an alternative approach.

The U.S. Government should immediately convene conferences of both the creditor governments and creditor banks. The purpose of these conferences would be to forestall the precipitation of default by offering the Polish regime the following deal.

If the Polish Communist authorities will:

1. Lift martial law immediately;
2. Release all political prisoners and detainees;
3. Revoke all decrees and regulations issued by the martial-law regime;[2]
4. Sit down with the Presidium of the Independent Self-governing Trade Union "Solidarity" and its advisers and start to negotiate the social contract which, by the signatures of its Deputy Prime Ministers, Ministers, and Vice Ministers to more than 700 agreements with Inter-enterprise Strike Committees during August and September 1980, the Polish government obligated itself to conclude,

Then the Western creditor governments and banks will:

Grant a moratorium on all payments due or about to become due, with the proviso that, if agreement has not been reached within 3 months, the clock which stopped as of the date on which negotiations began would start to run again and the creditor governments and banks would reassemble to consider anew the question of whether Poland was in default.

As soon as agreement was reached between the two Polish parties, urgent and sympathetic consideration would be given to Poland's application for mem-

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[2] These decrees and regulations are illegal in any case, since the martial-law regime was not approved by the Polish Diet (Sejm), which was in session when the proclamation was issued, but was not asked to approve it, as the Constitution requires.

bership of the International Monetary Fund and to the establishment of a schedule for the extension of balance-of-payment credits to Poland in installments keyed to the implementation of the various provisions of the agreement with Solidarity.

Is This A Practical Proposal?—I can see three principal objections to such a proposal.

1. The West Europeans—specifically, the West Germans—would not agree to it, because they subordinate their policy towards Poland to their concerns about maintaining détente with the U.S.S.R.

2. The Polish Communists, under strong pressure from their mentors in Moscow, would reject it out of hand.

3. Even if these two hurdles were overcome, the Polish Communists would not implement an agreement with Solidarity in good faith.

As to the first, on what grounds could the West Europeans refuse to agree? The NATO Foreign Ministers on January 11 declared: "Only with reconciliation and genuine negotiations can the basic rights of the Polish people and workers be protected and the economic and social progress of the country be secured. Poland could then expect to enjoy fully the benefits of stability in Europe and of constructive political and economic relations with the West." A number of members of the Alliance, including the United States, have committed themselves to helping Poland economically if the dialogue with Solidarity is resumed. If the Western states mean what they say, they should spell out the conditions under which they would help and the resources they would be prepared to devote to this effort.

As to the second, the Soviet rulers will certainly object now, as they have from the beginning of the Polish Renewal. If, however, the American, West European, the Japanese creditors are united and determined to carry through with their resolve, the Soviet leaders would have to reckon for the first time on the development of a unified Western economic and financial policy not only toward Poland, but toward the U.S.S.R. and the other member-states of the Warsaw Pact, as well. During the decade of the 1980's—which Seweryn Bialer says will be "the harsh decade" for the Soviet economy—the Soviets are counting increasingly upon their continued ability to obtain capital from the West, as Mr. Rohatyn points out. A unified Western decision that Poland was in default would mean that the East would be unable to obtain further Western credits.

As to the third objection, the Polish leaders are learning now how impossible is the position into which they have blundered. So far, hard information from Poland is fragmentary. But those who know the Polish people know that they cannot be made to work productively at the point of a gun or under the shadow of a tank.

The question the Polish leaders now confront is this. Can they turn the clock back permanently to the conditions of the Stalin period? Eventually, they will have to conclude that they cannot. It is possible, of course, that they will be unable to resolve this dilemma in their own minds in the next few months and that martial law or something by another name with the same content and practical effect will drag on for half a year or a year. Sooner or later, however, "normalization"—the Communist code-word for re-Stalinization—must give way to the resumption of life under conditions which recognize that Stalin is dead and buried, his political culture of unrestrained terror cannot be revived, and a new and fearless generation has been born and grown up in Poland during the past 30 years.

Under these circumstances, the task of the West is to offer a reasonable way out to the Polish leaders. The choice should be theirs. They must choose either to follow the path of the confederates of Targowica, who, in 1792, conspired to betray Poland to the Tsaritsa Catherine II of Russia, or to try yet again to find the "Polish road to socialism."

The policy I suggest places that choice squarely before them, in the sight of the entire Polish nation.

It has the additional advantage—and it is a very important one—of serving as the starting-point from which the North Atlantic Alliance can enter upon the path it must take if it is to stop supporting the arms build-up of the Soviet Union and unlimited Soviet suzerainty over Poland and the other East European peoples.

Senator LUGAR. Thank you very much, Mr. Ambassador.

With the hub of people coming and going, I did not give the introductions of this panel that I would like to give.

You have all just heard from Ambassador Richard Davies, who is a career Foreign Service officer who retired in 1980. Ambassador Davies served in Warsaw, Moscow, and elsewhere and held a variety of positions in the State Department and in Eastern European affairs. He served as Ambassador to Poland from 1973 to 1978. Since his retirement from the Foreign Service, Ambassador Davies has lectured and written widely on Polish and Eastern European affairs.

The first panelist, Mr. Lawrence Brainard, is an international economist with the Bankers Trust Co. of New York. He has been closely involved with the question of the Polish debt. Among his written work is a most interesting monograph which he coauthored, entitled "The Role of Commercial Banks in Balance-of-Payments Crises: The Cases of Peru and Poland."

I should add that Mr. Brainard's remarks today should not be representative of the official policy of the bank with which he is associated but rather reflect his own judgments.

Our third panelist is Prof. Stanislaw Wasowski, professor of international economics at Georgetown University. He has written and lectured widely on foreign trade among the Eastern European nations and on the question of East-West trade. Most recently, his work has focused on the condition of the Polish economy, the Polish debt, and the economic thinking of the Solidarity Union.

Mr. Wasowski.

[Mr. Wasowski's biographical data follows:]

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PERSONAL

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EDUCATION

Institut d'Etudes Politiques, University of Paris, B.A., 1949, Political Science and History.

The London School of Economics, B.Sc., 1951, Economics (analytical and descriptive); Ph. D., 1955, International Economics.

EXPERIENCE

1975 to date: Professor of International Economics, Georgetown University, Washington, D.C.

1973 to date: John Powers Professor of International Business.

1971-75: Associate Professor of International Economic Policies, Georgetown University, Washington, D.C.

1970-71: Senior Economist (International Economics), Stanford Research Institute, Arlington, Va.

1965-71: Lecturer in International Economics, Georgetown University, Washington, D.C.

1964-70: Research Staff Member, International Economy, International and Social Studies Division, Institute for Defense Analyses, Arlington, Va.

1959-65: Assistant, later Associate Professor of Economics, Georgetown University, Washington, D.C.

1957–59: Assistant Professor, Economics, Duquesne University.
1955–57: News Editor, Economics, Radio Free Europe.
1953–55: Programme Assistant, British Broadcasting Corporation.
1951–52: Reported Writer and Research Assistant, Mid-European Research Centre, Paris.

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LANGUAGES

Polish, French, German, Russian, Czech (reading only).

STATEMENT OF STANISLAW WASOWSKI, PROFESSOR OF INTERNATIONAL ECONOMICS, GEORGETOWN UNIVERSITY, WASHINGTON, D.C.

Mr. WASOWSKI. Thank you very much, Mr. Chairman and Senator Biden. I am sorry I do not have a written statement. This is the beginning of the semester and the pressure of students on a professor is such that we do not have time to do anything except the absolute minimum. [General laughter.]

I would like to concentrate on one single issue, composed of four subissues. And the issue is what are the alternatives now in dealing with the debt? I would like simply to delineate four alternatives as I see them and to discuss them at various lengths of time.

I think it is important to look at them because they help us to choose policies now, not too late but in advance of future developments. Secondly, as Ambassador Davies said a minute ago, we should present them to Poland's rulers in full view of Poland's public opinion so that

they would know what they are faced with and the public opinion in Poland should know too.

The first alternative is to continue lending, perhaps more carefully than in the 1970's, to grant some moratorium on payments outstanding, and to hope for the eventual repayment, without any specific conditions except that in the future credit will be tighter. This is not a ridiculous solution. After all, I have heard many representatives of various banks who said something of that sort, and just before Christmas a representative of one of New York's banks said that he would favor that solution, that the military regime would introduce some order, and that order would lead to repayment.

So let us examine that solution for a moment. Let us imagine that it is adopted, and let us look at a few figures. The recent Polish Government's plan of the summer of 1981 provided that the repayments would start in 1987 but seriously in 1988, and they would continue roughly speaking at the rate of $2 billion a year for about 13 to 14 years.

Later on, things happened that we know—namely, the military intervention—that probably delayed the possibility of the start of repayment by, say, 2 years to, shall we say, 1990 and stretching toward 2003. If you look at the value of these repayments, given the rate of inflation of only 6 percent on the average, we would get back less than $10 billion of today's dollars. And we would get them back much later than now; roughly speaking, the middle payment would be made about 1997.

The problem is not so simple as it would seem, because meanwhile the projections of the Polish Government would expect that the West would provide additional credits. One projection said $17 billion, another $10 billion. After the military intervention and disarray it has caused in the Polish economy, the required additional credits would be higher, shall we say, $11 or $18 billion. Therefore, according to these projections, if we followed that road we would have to provide $11 billion, maybe $18 billion in new credit to recover about $10 billion back.

If there was ever an example of throwing good money after bad, this is it. And I do not want it to happen, but it would be a very convenient textbook example to be used in classrooms.

Senator BIDEN. Professor, may I interrupt you for a second? I want to apologize. I am going to have to leave, but I will read your testimony. I am very anxious to hear what your other three alternatives are which you have set out. But I really must leave, and I do apologize.

Mr. WASOWSKI. Thank you very much. That is quite all right.

And yet people who propose that alternative, in fact, implicitly are thinking that the military order would lead to the economic recovery—without any basis in fact, because this economic recovery proposed to happen would have to be based on new ideas, and we have not seen new ideas yet. And when it comes to past practice of the Communist regime, it has led to an economic disaster.

Therefore, I think it is rather shortsighted to propose it, and I will call that alternative "throwing good money after bad."

The second alternative is to declare default on Polish debt. What would be the consequences? It would mean that in various countries, depending on their specific laws, creditors could seize Polish assets

amounting to about $250 million in various banks and consisting of current funds used for various operations and the Polish fleet worth at today's deflated prices perhaps $250–$300 million, altogether half a billion, to compensate for the debt of $28 billion.

Of course, there would be attempts to negotiate and after prolonged negotiations a bankrupt economy would declare payments perhaps equal to 20–30 percent of the debt, stretched over a long period of time. Meanwhile, balanced trade could be conducted and the Poles could buy as much as they would earn by exporting to the extent to which laws of various countries would allow for that. But I am sure they could always find a country that would allow such operations to be done without Polish goods being seized by creditors.

The important point here is that if that happened, it would affect very much the credit standing of all Eastern Europe and the Soviet Union. Nevertheless, let us remember that the default would be declared at our initiative and, hence, the extent of the damage to the credit standing of other Communist countries is not easily predictable. The extent of the ensuing credit restrictions will be known once the default has been declared but by then our leverage will have been lost. All the arrows from our quiver will be spent.

Now, let us see the obverse of it. If Poland declares itself in bankruptcy, the technical consequences will be similar but the political and psychological quite different. This would have meant an end of the umbrella theory, torn to shreds. And very general and very widespread lack of confidence in the repayment of credits by either other countries of Eastern Europe or the Soviet Union would follow.

Then the Yamal pipeline, which we wanted to affect somehow by various devices, including the action concerning the pipelaying tractors, would probably not be easily put into action, perhaps not at all, because there would be not many banks that would be very glad to lend money if the bankruptcy declaration came from the East.

And I would call, therefore, that alternative if the West declared the default, the policy of "one single salvo." And then nothing else would be left for us to do.

The third policy would be a different one, similar to what is being done currently. Western banks would very much stress the fact that Poland is a high-risk country, and they would be very careful with lending. There would be no legal reason to stop lending, but there would be very few who would dare to lend because of the pressure of their legislators, courts, and their customers who deposit money in the banks.

Then we could observe the continuation of trade on a low level. We could try to exact some interest payments at least in the framework of bilateral trade agreements between various Western countries and Poland, we would press for the repayment and wait for it without losing on the one hand any legal claim to it, and on the other without using that Sword of Damocles which is the formal declaration of default.

And I will call that alternative "Sword of Damocles," if I may.

The fourth alternative is different. It would provide for further credits and a moratorium under the condition that Poland introduces various reforms leading first to economic efficiency and second to larger exports to the West.

And I would like to discuss this alternative at some length, to devote most of my attention to it. And I would want to draw your attention, Mr. Chairman, to the fact that I am not going to use the array of arguments and proposals that might have been devised in the West, but I am going to pick up from the Polish economic press ideas formulated sometimes by people in Solidarity, sometimes by the experts of the Government, sometimes by party people. That is to say, this is the cross section of the Polish opinion that emerged during the last 16 months.

Among the proposals that appeared in Poland before December 13, are many that, when implemented, could substantially enhance the performance of the economy and increase the ability to service, and eventually repay, the debt to the West. Western creditors, it is submitted, could do worse than to turn their attention to these proposals and focus their attention on those with real promise. The decision to support some of the native ideas instead of being seen to try to impose Western conditions would make it easier for both Warsaw and Moscow to swallow a medicine not entirely of their liking.

The Poles would have to deal with the economic crisis as distinct from the task of reforming the economy. Two important factors contributing to the crisis are the excess of purchasing power over the volume of goods available to the consumers, and a complete disarray of the supply system resulting in multiple bottlenecks throughout the economy.

The first requires that they deal with it very quickly by increasing prices or by removing some of the purchashing power from the circulation. The second requires that lateral links be allowed between factories to make sure that goods that exist in the warehouses can move from one factory to another and support the economic activity and that excessive regulation of economic activity be abolished.

Just for the sake of an example, let me say that even minor changes in the process of production have to be approved at a very high level. Let me mention one simple example. In the summer of 1981 a well-known factory of candy in Poland stopped production because they had not enough sugar. They could continue production if they were allowed to use, say, 20 percent of sugar and 80 percent of syrup. The current proportion was 40 to 60. But it takes the permission of the Council of Ministers to make such a change, and it usually takes 3 months to get such permission. And as in the summer of 1981, the Government was very busy with Central Committee meetings, special congress of the party, and negotiations with Solidarity, that permission, to my knowledge, was not given until the time of the military intervention; storage bins remained full, production of candy did not take place.

If you have such structures that even minute decisions depend on the power of people on the top who simply have no time and they cannot spare their attention to it, then indeed the economy cannot work. If, however, lateral links were introduced, many bottlenecks could be removed very easily. So much for the immediate task of overcoming the crisis.

Then we have tasks of other sorts having to do with the economic reform. Investment decisions would have to be made. And very briefly, how much of it, what kind, what to do with the so-called

industrial ruins, the half-started investments which have not been finished, should they be finished or not.

And here, the knowledge of Western markets that the creditors of Poland—namely, Western banks—have, could be very helpful to find out what should be produced, which investments should be continued, which of them should have full supply of parts and raw materials and some semifinished products in order to be able to sell their finished products in the West to repay the debt.

Then you would have to look at the efficiency among the firms and inside the firms. Achieving efficiency among the firms would mean less allocation—I mentioned that a minute ago in another context—and less ordering about by the people on the top who have no direct knowledge of conditions of production or incentives; it would mean more, as I called them, horizontal or lateral exchanges based on costs and not on spurious prices imposed by planners.

Efficiency in plants would mean, very simply, a new style of management. If people on the top will not dictate what to do and how to do it, one would need managers who can decide by themselves. The present managers in Poland are inefficient for two reasons. One of them, I quote here the opinion of the "Neue Zuricher Zeitung," a well-known Swiss newspaper says that "about 65 percent of Polish managers are incompetent." Second, many of these managers are bureaucrats who simply implement orders from above and who do not decide and have never learned how to decide on their own.

There, further, would be a question of exchanging them for a new crew. And the question arises where does one get that crew from. This calls for a gradual change because the new managers will not appear immediately; second, it calls also for new methods of developing and training new business decisionmakers.

And here the influence of workers councils can be of great importance as opposed to the influence of a bureaucracy that directs from above.

One needs to think of agriculture, supply of food for people, and fodder for animals which otherwise would die as they did in 1980–81 when 3 million pigs had to be slaughtered because there was no fodder for them. But also one would think about long-term inputs. There is enough land, there is enough ability, but there are not enough inputs. And, therefore, chemicals, machinery, tractors, fertilizers would have to be supplied initially in large quantities but later at a diminishing rate, because Polish industry would have to be able to produce them locally in a few years from now. These supplies would have to be allocated so as to favor more efficient, that is, mostly private farms.

Finally, one would have to look at the social component of the recovery and reform. In the West one talks in this context about the dialog between Solidarity and the Government. It would be needed for three purposes. One, for the removal of the money illusion or, if you like, the inflationary overhang. The same sort of confidence, the same sort of support would be needed that, let us say, the West German community gave to Chancellor Ehrhardt in 1948 when the reform of the mark was introduced.

Second, the social element would be important so that workers whose incentive to work has been destroyed by lack of incentives and

by injustice of the distribution system, could start reacting positively to incentives.

We know that wherever they produce in very small private enterprises, let us say, gardens, they respond to incentives as any other normal person does.

Third, there is a need for a wide understanding between the society and the Government concerning the role of free unions and genuine workers' councils in assuring the development and training of the management of a new type. New managers would have to direct enterprises directed neither by shareholders, nor by central state authorities or other Government bureaucrats. New and untested form of conflict resolution between workers and consumers and public interest would have to be hammered out in the special climate, marked with a considerable degree of mutual confidence. The Government which destroyed recently the basis for such a confidence would have to undertake steps to make its revival possible.

Western creditors have an interest in seeing such reforms introduced for they would create a basis for turning Poland into a competitive and efficient economic partner.

Creditors, as is the wont of bankers, would probably find it easier to cooperate with Poland if two other conditions were satisfied. Creditors wish to be informed about the state of economic health of a debtor once exposed to a serious disease.

The banks, especially American and Swiss are pressing for information for the access to the very sources of information, not merely for the freedom of obtaining releases, which may be incorrect.

Second, to respond to creditors' wishes one would have to introduce conditionality of further payments, and further transfer of aid and credit, whatever applicable. And here, it would be very important if creditors could have the cooperation of the IMF, if Poland joined the IMF because the Fund would carry the stamp of the objectivity of international institutions. That does not change the substance but helps in allaying the suspicions of the governments in Warsaw and in Moscow.

I would like to end by briefly relating these economic changes to the political demands that we are making on the Government of the Polish Peoples Republic. The end of the martial law, the resumption of dialog, and the removal of shackles from the labor unions, form free unions would, of course, offer a way for new economic methods discussed above.

They would help in gaining society's support in overcoming inflation, providing for higher productivity, and introductory new forms of management that have not been tried neither in the West nor in the East. And, of course, they would also help to promote appropriate relations in agriculture where there is a question of a new sort of balance between the socialized and the private sector.

Therefore, our political demands that we have on the Polish Government now in view of the military takeover would help in promoting the economic reforms of the sort I am outlining.

These reforms, would in turn strengthen certain political changes that we would like to see there, such as the greater—economic, not the political role of Solidarity—such as the importance of a true dialog among the three major forces in the society.

Of course, a question still remains open—how should I call this alternative? I shall call it statesmanlike. And a second question, what can be done about persuading the Communist side, Moscow especially, to accept it? I think that as I spoke very long, I will be very glad to answer these questions in the question-answer period.

ANALYSIS OF FOUR ALTERNATIVES

Senator LUGAR. Thank you very much, Professor Wasowski. I think that your analysis of the four alternatives was simply brilliant and a very important contribution to the public understanding of what we are looking at, because I have read, and I am certain you have, a great deal of superficial analysis of what our alternatives are. I think you have expressed them well.

But I have pointed out that there are folks—and there have been many—who suggest that we continue on lending without specific conditions, that order is being brought about in Poland and in fact more order than they had before and we are more likely to get your money.

It is really extremely important that that idea be dispelled both intellectually as well as practically. And I think that you have by suggesting this extraordinary timetable and the present-value-of-money analysis, which means, as you have suggested, that you pay maybe $17 billion to collect $10 billion, and even that in the mid-1990's or after the year 2000, and as you have characterized it, are literally throwing good money after bad.

I suppose, in fact, as you have proceeded through your analysis, it was important to mention what default means and how we would chase about after the fleet and the few assets that are there and the difference if on the other side Poland were to declare a default, shredding the so-called umbrella and throwing the pipeline into jeopardy.

Finally, it seems to me all three of you gentlemen came to a conclusion that the fourth alternative, which involves conditionality, is probably where we ought to be headed. This is why with the previous panel I suggested, I hope tactfully or forcefully to Mr. Hormats specifically, that it seems to me imperative that the administration begin to think what the conditions ought to be.

He suggested, if you will recall his testimony, that in due course, if martial law were lifted or some things began to happen, the pencil might be applied to paper and we would begin to think through this. I think Senator Biden and I were more insistent that that really has to happen now.

As a matter of fact, the three of you have presented, I think, to my knowledge, the best public analysis of what the conditions ought to be. You have a remarkable degree of unanimity, even to the point of engagement of the IMF and international relationships that might be included after we get beyond these three political conditions which are sort of the sine qua non for all of you.

We still have the problem, as you suggested, professor, that if you have a society in which it takes 3 months to determine whether you get 20 percent sugar as opposed to 80 percent sugar in syrup in candy as opposed to a 40–60 ratio, you have real problems in terms of putting any money into that type of relationship.

I would just ask you and others to comment. Let us take as a point of departure the thought that we would loan money conditionally after the three political aspects are satisfied, if we saw some cures to inflation, some horizontal decisionmaking or, as you have characterized it, the inefficiency in the system, some change of management.

You suggested maybe 65 percent of the managers are incompetent. That is a very startling charge, if true, for an entire economy. But let us say that there is a high degree of incompetence, and you tried to recruit other people to do the management job. This sounds to me, on the face of it, like a rather awesome task.

Even if there were to be tactful supervision from the IMF or if Poles were to make the suggestions as you have thought they have in one way or another, really how does all of that get done in a society that does not have a market structure or the sorts of incentives that you have suggested are very likely to succeed?

Mr. WASOWSKI. It seems to me that we would be facing the needs for a learning process. One of the problems that Solidarity had, with which I very much sympathize, is the fact that things happened too quickly. In 1 year or 16 months they could not learn how to operate as a democratic group, unified in its thinking and at the same time aggressive and yet not being seen as aggressive.

These are things that are very difficult even for very seasoned politicians who have lived since their childhood in a democratic society. Polish workers and activists were suddenly thrown, so to speak, into that bath of democracy, and within 16 months they have not managed it too badly, although the record will show some mistakes and even errors.

Therefore, gradualness is very important, for instance, in finding good and appropriate managers if "Neue Zuricher Zeitung" is correct. If 65 percent of managers are incompetent, we cannot change all of them suddenly. It will take, say, 5 years. But there should be a plan of change that must be followed.

Similarly, an introduction of prices—I am all for free prices and a free market—but in the areas in which we have insufficiency of basic goods, you cannot introduce suddenly free prices, you have to do it gradually. This goes for many other aspects of economic activity or societal activity in Poland.

The point is that many proposals that have been made in Poland about such changes take into account the gradual element. I will not bore you with the specific sorts of several of such very reasonable proposals, but definitely that element is there.

But the principle of gradual change could be also linked to our gradual providing of credits to Poland. If they do not follow the agreed process of gradual change, then we stop giving them credits. The American banks—I am sure Mr. Brainard will know much more about it than I know—have tried that while financing the development of copper mines in Poland. Unless the development of copper mines proceeded according to plan, the next tranche of credit would not be forthcoming. That did not work too badly.

But the gradual change would also mean that perhaps Solidarity would first concentrate on economic tasks such as the selection of

managers, or the provision of horizontal links which could be less disquieting to Moscow and to some hardliners in Poland.

I am thinking of gradualness as a requirement of the economic situation and societal situation and at the same time as something that may be the coating on a bitter pill for the Communists to swallow.

Why will they have to accept it, or why do we think they might be willing to accept it, which is a more correct statement? The burden of paying Polish debts for a bankrupt Poland is an extremely great burden even for the Soviet Union, which has timber, which has gas, which has oil, and which has gold, but also low growth rates and its own deficits.

They need their resources for many of their economic needs at home and throughout the world. I am not certain that we would succeed, but at least it seems to me we see a plan of recovery and reform while diminishing their worries at the same time.

SOVIETS MIGHT BE AMENABLE TO CHANGE

Senator LUGAR. So your suggestion is that at some point, because of the expense to the Soviet Union, they might be amenable to change.

And it seems to me, beyond that, you are suggesting that the changes themselves, really the new book on what is to happen, could come from the Poles and from suggestions that have already been made, from your studies you have witnessed and you have characterized in your testimony not as prescriptions that we would be fostering here but rather as things that the Poles might write up themselves.

Just as purely a matter of technical import, is it conceivable that even though all these things would be gradual, someone in Poland, or rather some group in Poland, would in fact have written a book of where we are going, in other words, several chapters?

Could we hope that before we get back into giving even gradual credits, that there is a plan, a Polish plan written by Poles perhaps, but a plan, something that is sort of reduced to writing that we can follow to note benchmarks and progress and that is acceptable for reasons of stress that we have talked about to the Soviets so that it happens to come into effect?

Mr. WASOWSKI. The many expressions of protest of various sorts that came from Poland in the last several weeks, such as the protest of intellectuals, signed by the most important intellectuals and artists, show that there are still people who think independently, who are not crushed by fear, and who voice their opinions.

And it seems to me that the need for Western credits, for the moratorium, and so on, might lead even the military leaders of Poland to allow for sufficient degree of nonofficial exchange between, let us say, American, British, German scholars, economists, and Polish scholars to hammer out ideas, to exchange views about these ideas and help them develop such plans.

Indeed, I would very much welcome it. If anything, I would like to see it as the best solution. I very much welcome your suggestion. It seems to me that one should proceed that way to nurse along these thoughts rather than impose. I think the political significance of that difference is enormous.

Ambassador DAVIES. Senator, I think with regard to your question, there are many plans and there is a very substantial degree of agreement between Government economists, or perhaps I should say responsible Polish Government economists and Solidarity economists. The problem is that both groups of economists now have had their mouths shut. The Solidarity economists are either interned or under the threat of being arrested if they try to say anything.

And the Government economists have been fired from their jobs; that is, those who were preparing the reform plans.

But there is a very substantial area of agreement between these two groups as well as a number of plans that were written out, beginning with the Polish Society of Economists plan of October 1980, which the Government promptly swept under the rug because it was too liberal and contained too many sensible suggestions.

Beginning with that and going on to a whole series of other plans, there would be no problem of this. Professor Wasowski is exactly right. We do not have to—although I feel strongly that this Government and Western governments ought to have some concept of what is required before we would be prepared to finance any Polish recovery program. We should develop that concept for our own guidance, not in an effort to impose that upon the Poles. The effort should be to get the Poles to sit down, which Solidarity, for 16 months was trying to get the Government to do, and work out this economic reform program.

Let them come forward with the program, and let us through the IMF, through advisory groups, including gentlemen like the two at the table with me, and many others in the West who are familiar with the Polish economy, let us then judge the recovery program. We have a very shrewd idea, I think, between the bankers and the economists of what is required of such a program.

I would like just to raise one other point. Senator Biden was asking questions about the Polish Government's ability to operate without the Soviets stopping them.

PROGRAM AND GUIDELINES

Well, I think it is too simple to look at this problem as one in which the Soviet Government tells the Polish Government, even General Jaruzelski, exactly what to do. The fact that they were not telling the Poles what to do and the Poles were not automatically doing it is shown by the fact that you had 16 months during which the Soviets were urging the Poles to do something and the Polish regime was refusing to do something, for a whole variety of reasons.

So it is too simple to look at this in terms of saying, well, the Soviets will never let them do it. We should put on the table a program, a highly articulated, worked-out program on the Western side of what we would require. We should put those guidelines on the table, not as something we are trying to impose on the Poles but as the result of a discussion in the West, agreement among the Western governments as to what we would require before we could resume normal economic dealings with Poland.

Even more importantly—and this is where the Soviets come in—we have to take effective actions vis-a-vis the Soviets, which we have

not yet done. That is why I insist the grain embargo continues to be very important. I know it is extremely difficult for this administration to contemplate the grain embargo, but you have to show the Soviets that they can be hurt and the grain embargo would hurt them now.

They have bread rationing in the Soviet Union right now. They are not able to get the shortfall, which is enormous this year, between their harvest and what they require in the international grain market without American grain. In fact, they will be coming to us shortly, you can be sure of it, asking for more than the 23 million tons of grain that this administration has authorized them to purchase. They will be coming to us before the end of the current grain year which ends at the end of September and asking for more grain, provided we have it to sell.

We should not only not give them that grain, but we should not let them take the 23 million tons, because that is our major means of leverage on them to let the Poles work these problems out themselves.

Senator LUGAR. I appreciate very much the point that you made about the need for us to think through what we want. This is one of the major reasons for calling this hearing. I simply have the feeling that we have not done this—I would not characterize our policymakers as being without ideas, but systematically—I do not think they have thought through the conditionality and really how to proceed.

The integration of your ideas, Ambassador, with those of the professor are interesting. Probably in order for us to be helpful in this dialog of economists or academicians or others who might in due course be able to flow back and forth, we really have to know what we want and have some criteria and then see the degree, I suppose, to which the Polish analysis meshes with this.

I would say—and I am certain you have been involved in similar contacts—that only a few months ago leaders from Solidarity and the Polish Government came to this country, to this town. They met here, not too far away, with members of our State Department.

Ambassador DAVIES. We participated in that meeting.

Senator LUGAR. Exactly. In that case, there was this kind of meshing of minds of people who were thinking specifically about coal exports, as I recall, in some of those discussions and other ways in which export credits might come about. So this is not a farfetched suggestion. As a matter of fact, we have all been involved in these things rather recently. I think we must use that experience now to reduce to some organization our thoughts and criteria.

EXPLICIT AND DETAILED ECONOMIC CONDITIONALITY

Mr. Brainard, you have participated in all of those, too. And as a matter of fact, your concluding statement was an important one. You said any future decision to establish Polish debt should be based on explicit and detailed economic conditionality.

Mr. BRAINARD. I might just add a few comments as to what I have in mind there. Of course, to work out conditionality, one first of all has to have a certain amount of information. It is interesting that the various governments, the 17 who signed the rescheduling agreement, did not request a full disclosure of Polish economic data. The banks did

request this and did receive extremely detailed data on the Polish economy.

Senator LUGAR. You said the banks requested and got it, but the governments involved did not?

Mr. BRAINARD. They did not ask.

Senator LUGAR. Why would they be so negligent?

Mr. BRAINARD. The reason they did not ask is because they were unwilling to follow the concept of conditionality to its logical conclusion.

Senator LUGAR. In other words, to face the consequences, if they got the information, the answers?

Mr. BRAINARD. That is right. What they were focusing on is what to do in case of an invasion. But they were not focusing on issues—as they are not focusing on today—of what will be their policy if martial law is lifted and there is a request for credit. They are not prepared to deal with that.

IMPLEMENT STANDARDS

What kinds of standards can be implemented? There are some things that can be implemented gradually, but some things would have to be done all at once.

The economic situation is extremely bad. For this reason it is my view that the stabilization of the monetary system has to be done very, very quickly. Money and prices are so out of line that to realine them on a gradual basis would take too long. Since the economy is already so depressed, probably the best approach is to do it all at once.

However, there are a number of other areas in which we would be able to specify specific standards of economic performance. And gradually, on a quarterly basis, for example, we could measure whether they were coming more into balance or not. If they were making progress in reducing various kinds of disequilibria in consumer goods markets, in producers markets, in foreign trade, in money and income creation, and so forth, we could make conditional payments of credit on that basis.

We could set up specific standards of economic performance, maybe five or six of these, and these would be the key elements by which we would monitor whether the economy was moving to a better allocation of resources, more of an equilibrium situation or not. And we could have specific actions triggered to the assessment of these trends.

I do not think we should kid ourselves here. Austerity is essential in the Polish situation. We are not talking about a situation in which we can have our cake and eat it too. There will have to be a tremendous price paid by the Polish society for stability. And that is why the points that you mentioned earlier, the political points, essentially the creation of a social contract, is absolutely essential.

Following that, I think that the key elements that have to be brought in are: one, the stabilization of the monetary system, because effectively they have acted to destroy the domestic currency over the past 18 months; and two, the restoration of an economic structure because they are moving now on a totally ad hoc sort of basis. They have even abolished the annual plan; they do not have an annual plan.

There are specific areas, like agriculture, where they have to get things right or else they are not going to be able to eat. So one can go down such areas to establish various priorities and various kinds of policy measures to address these.

I would not be reluctant to impose our own ideas of conditionality. I agree with Professor Wasowski's comment that many of these proposals have already been made in Poland. I would not hesitate, however, to establish our own concepts of these conditions, because, after all, it is a situation in which they have defaulted on their debt. We have a right to do this.

Senator LUGAR. Gentlemen, do you have further comments? I know I have taxed your time and your patience. But I would offer one further word.

Mr. WASOWSKI. I would like to say one or two sentences, if I may. I quite agree with Mr. Brainard that the monetary system, agriculture and the coal production, should be dealt with at once. There is no place and no time for the gradual approach here. I quite agree.

When it comes to austerity, it seems to me that it is a very interesting complex of social and political and economic problems. Solidarity was ready to propose austerity, or Walesa was ready to agree to it. Some extremists in his group would not.

Let us assume that Walesa had access to TV. He could persuade both the population to accept austerity on his authority and also go to the Solidarity over the hotheads who did not want to accept it. And in that way he could win on both ends, so to speak, and help in the acceptance of austerity, acceptance of a very tough price reform, in order to start from there.

But that required precisely the access to the media. In the fall of last year the Polish newspapers sympathetic to Solidarity and the weekly Solidarity itself were stressing the fact that if the government is serious about introducing reforms, a beginning of reforms, by increasing prices and having it accepted, they should admit Solidarity leaders to appeal to the population to accept it. Without it they would not be acceptable, because the population would not have a clear lead from those whom they trust. This issue can serve as an illustration of a very important nexus between the freedom of information, social forces, and economic reform.

I would like to end with that.

Senator LUGAR. Ambassador Davies, do you have further comment?

Ambassador DAVIES. Senator, the only thing I would want to say is that I think this hearing should prove to be very useful. I regard this subject as one which I know you do not believe you have exhausted, but I think you should be returning to it recurrently, because the Polish problem or crisis is going to be with us for some time.

And it does seem to me, being a former bureaucrat myself, that inevitably bureaucrats have 1,000 things to do which seem to be more important than the kind of longer range views which perhaps we have been talking about here.

So I would hope you could continue to keep the pressure on, to put it metaphorically.

Senator LUGAR. You have put it very well. I would say, without using terms such as "pressure," that we will simply illuminate the

territory from time to time to make certain that we are making progress. I have a feeling that we may stir some progress from today's activities. But we will check.

I will call upon each of you to be helpful as you survey the events of the next few weeks and maybe fine tune or update even your own thoughts, which have been inordinately helpful today. We are grateful to you.

The hearing is now adjourned.

[Thereupon, at 5 p.m., the subcommittee adjourned, subject to call of the Chair.]

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